Department of Defense
Agency Wide
CONSOLIDATED BALANCE SHEET
As of March 31, 2005 and 2004

	2005 Consolidated	2004 Consolidated
1. ASSETS (Note 2)		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 464,079,428,887.63	$ 493,543,064,796.99
b. Non-Entity Seized Iraqi Cash	191,104,159.34	194,924,909.70
c. Non-Entity-Other	316,264,399.24	659,845,126.55
2. Investments (Note 4)	265,441,773,866.15	235,261,595,141.31
3. Accounts Receivable (Note 5)	1,883,143,080.15	1,343,609,003.43
4. Other Assets (Note 6)	1,065,241,743.51	144,043,522.36
5. Total Intragovernmental Assets	$ 732,976,956,136.02	$ 731,147,082,500.34
B. Cash and Other Monetary Assets (Note 7)	$ 2,164,599,045.83	$ 1,659,189,379.36
C. Accounts Receivable (Note 5)	7,258,782,353.96	6,834,909,094.11
D. Loans Receivable (Note 8)	72,623,202.46	67,070,055.10
E. Inventory and Related Property (Note 9)	209,265,292,555.80	214,205,307,652.73
F. General Property, Plant and Equipment (Note 10)	447,609,666,400.80	446,884,240,660.89
G. Investments (Note 4)	502,593,130.00	378,050,630.00
H. Other Assets (Note 6)	24,710,846,721.58	23,148,827,340.46
2. TOTAL ASSETS	$ 1,424,561,359,546.45	$ 1,424,324,677,312.99
3. LIABILITIES (Note 11)		
A. Intragovernmental:		
1. Accounts Payable (Note 12)	$ 1,929,348,839.47	$ 738,463,775.84
2. Debt (Note 13)	585,597,488.22	691,063,340.87
3. Other Liabilities (Note 15 & Note 16)	10,635,752,948.33	10,686,213,430.41
4. Total Intragovernmental Liabilities	$ 13,150,699,276.02	$ 12,115,740,547.12
B. Accounts Payable (Note 12)	$ 27,476,272,107.02	$ 25,173,679,251.82
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,569,704,931,314.22	1,429,565,352,698.50
D. Environmental Liabilities (Note 14)	63,706,856,124.53	61,571,736,675.37
E. Loan Guarantee Liability (Note 8)	45,819,277.64	22,816,285.30
F. Other Liabilities (Note 15 & Note 16)	31,843,699,001.22	29,530,230,536.72
4. TOTAL LIABILITIES	$ 1,705,928,277,100.65	$ 1,557,979,555,994.83
5. NET POSITION		
A. Unexpended Appropriations	$ 429,735,380,471.63	$ 461,343,479,005.62
B. Cumulative Results of Operations	(711,102,298,025.83)	(594,998,357,687.46)
6. TOTAL NET POSITION	$ (281,366,917,554.20)	$ (133,654,878,681.84)
7. TOTAL LIABILITIES AND NET POSITION	$ 1,424,561,359,546.45	$ 1,424,324,677,312.99

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF NET COST

For the periods ended March 31, 2005 and 2004

	2005 Consolidated	2004 Consolidated
1. Program Costs		
A. Intragovernmental Gross Costs	$ 10,877,667,371.73	$ 6,074,907,047.12
B. (Less: Intragovernmental Earned Revenue)	(8,417,083,283.57)	(6,517,260,569.45)
C. Intragovernmental Net Costs	$ 2,460,584,088.16	$ (442,353,522.33)
D. Gross Costs With the Public	236,346,228,951.84	226,735,472,271.61
E. (Less: Earned Revenue From the Public)	(13,687,149,462.57)	(11,620,848,350.29)
F. Net Costs With the Public	$ 222,659,079,489.27	$ 215,114,623,921.32
G. Total Net Cost	$ 225,119,663,577.43	$ 214,672,270,398.99
2. Cost Not Assigned to Programs	0.00	8,847.45
3. (Less:Earned Revenue Not Attributable to Programs)	0.00	0.00
4. Net Cost of Operations	$ 225,119,663,577.43	$ 214,672,279,246.44

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended March 31, 2005 and 2004

	2005 Consolidated	2004 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ (745,441,240,189.41)	$ (621,610,712,064.01)
2. Prior period adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	0.00	(14,309,208,905.32)
2.B. Beginning Balance, Restated	(745,441,240,189.41)	(635,919,920,969.33)
2.C. Prior Period Adjustments - Not Restated (+/-)	0.00	0.00
3. Beginning Balances, as adjusted	(745,441,240,189.41)	(635,919,920,969.33)
4. Budgetary Financing Sources:		
4.A. Appropriations received	0.00	0.00
4.B. Appropriations transferred-in/out (+/-)	0.00	0.00
4.C. Other adjustments (rescissions, etc) (+/-)	0.00	5,436,561,000.00
4.D. Appropriations used	258,673,091,243.57	239,824,757,422.61
4.E. Nonexchange revenue	988,078,171.11	493,649,908.84
4.F. Donations and forfeitures of cash and cash equivalents	24,246,904.36	2,324,575.57
4.G. Transfers-in/out without reimbursement (+/-)	2,852,464,426.94	239,083,302.24
4.H. Other budgetary financing sources (+/-)	(5,203,265,070.24)	10,616,537,189.76
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	112,000.00	(47,661.81)
5.B. Transfers-in/out without reimbursement (+/-)	(2,152,178.77)	(2,845,795,194.84)
5.C. Imputed financing from costs absorbed by others	2,148,143,053.59	1,994,868,646.93
5.D. Other (+/-)	(22,112,809.55)	(168,096,660.99)
6. Total Financing Sources	259,458,605,741.01	255,593,842,528.31
7. Net Cost of Operations (+/-)	225,119,663,577.43	214,672,279,246.44
8. Ending Balances	$ (711,102,298,025.83)	$ (594,998,357,687.46)

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended March 31, 2005 and 2004

	2005 Consolidated	2004 Consolidated
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	$ 243,813,788,091.23	$ 192,955,803,473.31
2. Prior period adjustments (+/-)		
2.A. Prior Period Adjustments - Restated (+/-)	0.00	25,913,749,160.94
2.B. Beginning Balance, Restated	243,813,788,091.23	218,869,552,634.25
2.C. Prior Period Adjustments - Not Restated (+/-)	0.00	0.00
3. Beginning Balances, as adjusted	243,813,788,091.23	218,869,552,634.25
4. Budgetary Financing Sources:		
4.A. Appropriations received	447,440,344,919.00	487,673,777,566.22
4.B. Appropriations transferred-in/out (+/-)	(544,320,671.00)	677,594,697.94
4.C. Other adjustments (rescissions, etc) (+/-)	(2,301,340,624.03)	(6,052,688,470.18)
4.D. Appropriations used	(258,673,091,243.57)	(239,824,757,422.61)
4.E. Nonexchange revenue	0.00	0.00
4.F. Donations and forfeitures of cash and cash equivalents	0.00	0.00
4.G. Transfers -in/out without reimbursement (+/-)	0.00	0.00
4.H. Other budgetary financing sources (+/-)	0.00	0.00
5. Other Financing Sources:		
5.A. Donations and forfeitures of property	0.00	0.00
5.B. Transfers -in/out without reimbursement (+/-)	0.00	0.00
5.C. Imputed financing from costs absorbed by others	0.00	0.00
5.D. Other (+/-)	0.00	0.00
6. Total Financing Sources	185,921,592,380.40	242,473,926,371.37
7. Net Cost of Operations (+/-)		
8. Ending Balances	$ 429,735,380,471.63	$ 461,343,479,005.62

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended March 31, 2005 and 2004

	2005 Combined	2004 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 506,298,653,357.22	$ 539,525,282,843.69
1b. Borrowing authority	0.00	134,899.00
1c. Contract authority	44,953,247,455.39	39,335,328,188.17
1d. Net transfers (+/-)	(121,864,899.96)	1,133,342,380.09
1e. Other	19,243,899,455.69	21,289,075,018.38
2. Unobligated balance:		
2a. Beginning of period	293,956,869,248.72	259,054,449,252.08
2b. Net transfers, actual (+/-)	106,896,704.14	(1,226,798,492.39)
2c. Anticipated Transfers balances	0.00	0.00
3. Spending authority from offsetting collections:		
3a. Earned	0.00	0.00
1. Collected	73,785,370,559.11	66,849,667,191.84
2. Receivable from Federal sources	1,267,364,482.75	(44,829,466.61)
3b. Change in unfilled customer orders	0.00	0.00
1. Advance received	1,279,747,987.08	650,355,672.97
2. Without advance from Federal sources	19,905,739,047.55	16,762,500,974.37
3c. Anticipated for the rest of year, without advances	20,164,097,325.23	13,144,293,441.07
3d. Previously unavailable	0.00	0.00
3e. Transfers from trust funds	0.00	0.00
3f. Subtotal	116,402,319,401.72	97,361,987,813.64
4. Recoveries of prior year obligations	21,905,661,351.46	23,376,381,647.96
5. Temporarily not available pursuant to Public Law	(10,000,000.00)	0.00
6. Permanently not available	(17,292,197,506.61)	(20,011,266,662.16)
7. Total Budgetary Resources	$ 985,443,484,567.77	$ 959,837,916,888.46

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended March 31, 2005 and 2004

	2005 Combined	2004 Combined
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 347,812,542,531.04	$ 330,701,574,438.19
8b. Reimbursable	87,395,933,997.86	76,503,448,039.61
8c. Subtotal	435,208,476,528.90	407,205,022,477.80
9. Unobligated balance:		
9a. Apportioned	262,670,009,780.58	163,426,597,054.75
9b. Exempt from apportionment	215,784,338,645.45	210,278,167,564.03
9c. Other available	0.00	0.00
10. Unobligated Balances Not Available	71,780,659,612.84	178,928,129,791.88
11. Total, Status of Budgetary Resources	$ 985,443,484,567.77	$ 959,837,916,888.46
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
12. Obligated Balance, Net - beginning of period	$ 232,726,294,300.56	$ 213,896,676,403.25
13. Obligated Balance transferred, net (+/-)	0.00	(14,147,223.76)
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	(11,404,196,943.78)	(10,679,737,877.01)
14b. Unfilled customer order from Federal sources	(59,307,629,819.27)	(55,184,488,393.68)
14c. Undelivered orders	276,095,836,324.37	263,059,898,679.72
14d. Accounts payable	50,734,754,482.74	47,561,775,660.77
15. Outlays:		
15a. Disbursements	368,737,241,903.64	336,236,050,431.77
15b. Collections	(75,065,118,546.19)	(67,500,022,864.81)
15c. Subtotal	293,672,123,357.45	268,736,027,566.96
16. Less: Offsetting receipts	(46,359,452,653.15)	(40,238,184,867.46)
17. Net Outlays	$ 247,312,670,704.30	$ 228,497,842,699.50

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended March 31, 2005 and 2004

	2005 Combined	2004 Combined
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Budget Authority:		
1a. Appropriations received	$ 0.00	$ 0.00
1b. Borrowing authority	3,432,129.00	77,532,192.88
1c. Contract authority	0.00	0.00
1d. Net transfers (+/-)	0.00	0.00
1e. Other	0.00	0.00
2. Unobligated balance:		
2a. Beginning of period	24,520,250.64	21,845,045.69
2b. Net transfers, actual (+/-)	0.00	0.00
2c. Anticipated Transfers balances	0.00	0.00
3. Spending authority from offsetting collections:		
3a. Earned	0.00	0.00
1. Collected	12,013,309.16	9,702,548.87
2. Receivable from Federal sources	0.00	(587,592.88)
3b. Change in unfilled customer orders	0.00	0.00
1. Advance received	0.00	0.00
2. Without advance from Federal sources	318,315.00	911,763.00
3c. Anticipated for the rest of year, without advances	5,021,943.84	0.00
3d. Previously unavailable	0.00	0.00
3e. Transfers from trust funds	0.00	0.00
3f. Subtotal	17,353,568.00	10,026,718.99
4. Recoveries of prior year obligations	0.00	0.00
5. Temporarily not available pursuant to Public Law	0.00	0.00
6. Permanently not available	(1,912,714.00)	24,149,203.50
7. Total Budgetary Resources	$ 43,393,233.64	$ 133,553,161.06

Department of Defense

Agency Wide

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended March 31, 2005 and 2004

	2005 Combined	2004 Combined
STATUS OF BUDGETARY RESOURCES		
8. Obligations incurred:		
8a. Direct	$ 0.00	$ 19,309,615.24
8b. Reimbursable	0.00	0.00
8c. Subtotal	0.00	19,309,615.24
9. Unobligated balance:		
9a. Apportioned	5,545,037.32	1,272,636.32
9b. Exempt from apportionment	0.00	0.00
9c. Other available	0.00	0.00
10. Unobligated Balances Not Available	37,848,196.32	112,970,909.50
11. Total, Status of Budgetary Resources	$ 43,393,233.64	$ 133,553,161.06
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
12. Obligated Balance, Net - beginning of period	$ 155,747,457.81	$ 29,895,366.06
13. Obligated Balance transferred, net (+/-)	0.00	0.00
14. Obligated Balance, Net - end of period:		
14a. Accounts receivable	0.00	0.00
14b. Unfilled customer order from Federal sources	(83,401,138.00)	(36,761,353.00)
14c. Undelivered orders	238,830,280.81	73,242,164.18
14d. Accounts payable	0.00	0.00
15. Outlays:		
15a. Disbursements	0.00	12,400,000.00
15b. Collections	(12,013,309.16)	(9,702,548.87)
15c. Subtotal	(12,013,309.16)	2,697,451.13
16. Less: Offsetting receipts	0.00	0.00
17. Net Outlays	$ (12,013,309.16)	$ 2,697,451.13

Department of Defense

Agency Wide

COMBINED STATEMENT OF FINANCING

For the periods ended March 31, 2005 and 2004

	2005 Combined	2004 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 435,208,476,528.90	$ 407,224,332,093.04
2. Less: Spending authority from offsetting collections and recoveries (-)	(118,156,215,052.11)	(107,604,102,739.52)
3. Obligations net of offsetting collections and recoveries	317,052,261,476.79	299,620,229,353.52
4. Less: Offsetting receipts (-)	(46,359,452,653.15)	(40,238,184,867.46)
5. Net obligations	270,692,808,823.64	259,382,044,486.06
Other Resources		
6. Donations and forfeitures of property	112,000.00	(47,661.81)
7. Transfers in/out without reimbursement (+/-)	(2,152,178.77)	(2,845,795,194.84)
8. Imputed financing from costs absorbed by others	2,148,143,053.59	1,994,868,646.93
9. Other (+/-)	(22,112,809.55)	(168,096,660.99)
10. Net other resources used to finance activities	2,123,990,065.27	(1,019,070,870.71)
11. Total resources used to finance activities	272,816,798,888.91	258,362,973,615.35
Resources Used to Finance Items not Part of the Net Cost of Operations		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
12a. Undelivered Orders (-)	(52,644,121,784.71)	(49,760,179,529.69)
12b. Unfilled Customer Orders	21,185,805,349.63	17,413,768,410.34
13. Resources that fund expenses recognized in prior periods	(2,788,006,330.80)	(4,224,882,986.01)
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	1,381,301,686.76	449,537,167.89
15. Resources that finance the acquisition of assets	(51,489,919,330.64)	(63,319,005,815.89)
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations		
16a. Less: Trust or Special Fund Receipts Related to	(10,000,000.00)	0.00
16b. Other (+/-)	2,040,178.77	2,845,795,194.84
17. Total resources used to finance items not part of the net cost of operations	(84,362,900,230.99)	(96,594,967,558.52)
18. Total resources used to finance the net cost of operations	188,453,898,657.92	161,768,006,056.83

Department of Defense

Agency Wide

COMBINED STATEMENT OF FINANCING

For the periods ended March 31, 2005 and 2004

	2005 Combined	2004 Combined
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
19. Increase in annual leave liability	330,427,841.28	114,076,733.02
20. Increase in environmental and disposal liability	928,500,133.21	1,169,458,423.72
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0.00	0.00
22. Increase in exchange revenue receivable from the public (-)	40,731,462.15	(19,273,717.20)
23. Other (+/-)	412,821,758.25	677,753,222.37
24. Total components of Net Cost of Operations that will require or generate resources in future periods	1,712,481,194.89	1,942,014,661.91
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	19,456,326,956.48	34,039,804,058.02
26. Revaluation of assets or liabilities (+/-)	1,734,933,082.19	4,037,123,118.79
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	(12,271,749,622.56)	(11,815,370,193.76)
27b. Cost of Goods Sold	20,590,514,215.17	19,580,342,086.71
27c. Operating Material & Supplies Used	(124,164,344.05)	1,693,879,601.00
27d. Other	5,567,423,437.39	3,426,479,856.94
28. Total components of Net Cost of Operations that will not require or generate resources	34,953,283,724.62	50,962,258,527.70
29. Total components of net cost of operations that will not require or generate resources in the current period	36,665,764,919.51	52,904,273,189.61
30. Net Cost of Operations	225,119,663,577.43	214,672,279,246.44

Department of Defense
Agency Wide
STATEMENT OF CUSTODIAL ACTIVITY
For the periods ended March 31, 2005 and 2004

	2005 Combined	2004 Combined
1.SOURCE OF COLLECTIONS		
A. Deposits by Foreign Governments	$ 4,464,493,660.98	$ 5,138,632,772.17
B. Seized Iraqi Cash	700.00	117,714,144.23
C. Other Collections	0.00	0.00
D. Total Cash Collections	$ 4,464,494,360.98	$ 5,256,346,916.40
E. Accrual Adjustments (+/-)	$ 0.00	$ 0.00
F. Total Custodial Collections	$ 4,464,494,360.98	$ 5,256,346,916.40
2.DISPOSITION OF COLLECTIONS		
A. Disbursed on Behalf of Foreign Governments and International Organizations	$ 5,154,752,672.78	$ 4,941,910,083.06
B. Seized Assets Disbursed on behalf of Iraqi People	30,321,432.57	200,928,010.51
C. Increase (Decrease) in Amounts to be Transferred	(690,259,011.80)	196,722,689.11
D. Collections Used for Refunds and Other Payments	0.00	0.00
E. Retained by The Reporting Entity	0.00	0.00
F. Seized Assets Retained for Support of the Iraqi People	(30,320,732.57)	(83,213,866.28)
G. Total Disposition of Collections	$ 4,464,494,360.98	$ 5,256,346,916.40
3. NET CUSTODIAL COLLECTION ACTIVITY	$ 0.00	$ 0.00

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the "Chief Financial Officers Act of 1990," expanded by the "Government Management Reform Act of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the "DoD Financial Management Regulation," Office of Management and Budget Bulletin No. 01-09 (Form and Content of Agency Financial Statements), and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified.

The Department is unable to fully implement all elements of GAAP and Office of Management and Budget Bulletin No. 01-09 due to limitations of its financial management processes and systems, and nonfinancial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory systems and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Department continues to implement process and system improvements addressing these limitations.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 established the Department of Defense. The Department's mission is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies. Fiscal Year (FY) 2005 is the tenth year that the Department has prepared audited DOD Agency-wide financial statements as required by the Chief Financial Officers Act and Government Management Reform Act. Auditors are required to audit the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund, and (9) U.S. Army Corps of Engineers (Civil Works).

In addition to the nine stand-alone reporting entities, separate columns in the combining/consolidating statements are included with the financial information of the "Other Defense Organizations General Funds" and "Other Defense Organizations Working Capital Funds." The Office of the Inspector General will not issue separate audit opinions on the statements of the Other Defense Organizations; instead, the financial statements and records of those organizations are included in the audit performed to support the opinion issued on the DoD Agency-wide financial statements.

The Department requires the following Defense Agencies to prepare internal stand-alone annual financial statements to be audited by certified public accounting firms: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, and (7) Defense Threat Reduction Agency.

1.C. Appropriations and Funds

The Department receives its appropriations and funds as general, working capital (revolving funds), trust, special, and deposit funds. The Components use these appropriations and funds to execute their missions and report on resource usage.

General funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction accounts.

Working capital funds (WCF) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial cost of products and services. The WCF entities provide goods and services on a reimbursable basis. Receipts derived from operations generally are available in their entirety for use without further congressional action.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

Special fund accounts are used to process government receipts earmarked for a specific purpose.

Deposit funds are used to record amounts held temporarily until ownership is determined. The Department is acting as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

1.D. Basis of Accounting

For FY 2005, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department's legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Government Standard General Ledger (USSGL). Until all of the Department's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DoD's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, the Department identifies program costs based upon the major appropriation groups provided by the Congress. The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. The Department recognizes revenue when earned within the constraints of current system capabilities. In other instances, revenue is recognized when bills are issued.

The Department does not include non-monetary support provided by U.S. allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has cost-sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The Department's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses. Net increases or decreases in unexpended appropriations are recognized as a change in the net position. The Department adjusts operating expenses as a result of the elimination of balances between DoD Components.

1.G. Accounting for Intragovernmental Activities

The Department, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department.

Public Debt

The Department's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debts and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the Department of the Treasury does not allocate such interest costs to the benefiting agencies.

Inter/Intra Governmental Elimination

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the Department or between two or more federal agencies. However, the Department cannot accurately identify most of its intragovernmental transactions by customer because DoD's systems do not track buyer and seller data needed to match related transactions. For FY 1999 and beyond, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intragovernmental balances were then eliminated. The Department is to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with the existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In May 2004, the FMS issued the Treasury Financial Manual Part 2 – Chapter 4700 "Agency Reporting Requirements for the Financial Report of the United States Government." The Department is not able to fully implement the policies and procedures in this manual related to reconciling intragovernmental assets, liabilities, revenues, and expenses for nonfiduciary transactions. The Department, however, is able to implement the policies and procedures contained in the "Intragovernmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide," which has been updated and reissued on September 24, 2004. Both documents provide guidance for reconciling intragovernmental transactions pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the Office of Personnel Management (OPM).

1.H. Transactions with Foreign Governments and International Organizations

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance.

1.I. Funds with the U.S. Treasury

The Department's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U.S. Army Corps of Engineers (USACE), and the Department of State financial service centers process the majority of cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, and interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between the Department's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency

Cash is the total of cash resources under the control of the Department of Defense, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Cash available for agency use includes petty cash funds and cash held in revolving funds, which will not be transferred into the U.S. Government General Fund. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts. The majority of cash and all foreign currency is classified as non-entity and, therefore, restricted.

The amounts for cash and foreign currency reported consist primarily of cash held by Disbursing Officers to carry out their paying, collecting and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the reconstruction of Iraq.

The Department conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations (operation and maintenance, military personnel, military construction, family housing operation and maintenance, and family housing construction). The gains and losses are computed as the variance between the exchange rate at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Department does not separately identify currency fluctuations.

1.K. Accounts Receivable

As presented in the Balance Sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per the Code of Federal Regulations 4CFR 101).

DoD Components use a variety of techniques for estimating the Allowance for Uncollectible Accounts Receivable from the public. While the exact details differ among the Components, estimates are usually based on either a percentage of actual prior-year write-offs or a percentage of aged receivables from the public.

1.L. Direct Loans and Loan Guarantees

The Department operates a direct loan and loan guarantee program authorized by the National Defense Authorization Act for FY 1996 Public Law 104-106, Statute 186, Section 2801. The Act includes a series of authorities that allow the Department to work with the private sector to renovate military housing. The

Department's goals are to obtain private capital to leverage government dollars, make efficient use of limited resources, and use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually or in combination. They include guarantees, both loan and rental; conveyance/leasing of existing property and facilities; differential lease payments; investments, both limited partnerships and stock/bond ownership; and direct loans. In addition, the "Federal Credit Reform Act of 1990" governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

The Department also operates a loan guarantee program designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

1.M. Inventories and Related Property

Most of the Department's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the DoD Components have transitioned, and are continuing to transition, their inventory to the moving average cost method. Upon full implementation, the Department will be compliant with SFFAS No. 3. Approximately 5 percent of the inventories are now reported at moving average cost.

The Department manages only military or government-specific materiel under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies. Therefore, the Department does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future sale" based on SFFAS No. 3 definitions.

Related property includes operating materials and supplies (OM&S) and stockpile materials. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, and procured by general fund appropriations such as ammunition and engines, are generally recorded using the consumption method and reported on the balance sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2005, the Department expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item was in the hands of the end user.

The Department determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high-dollar items managed, such as aircraft engines, are categorized as OM&S rather than military equipment by DoD activities.

The Department implemented accounts for condemned materiel as "Excess, Obsolete, and Unserviceable." The net value of condemned materiel is zero, because the costs of disposal are greater than the potential scrap value. Potentially redistributable materiel, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in "Held for Use" or "Held for Repair" categories according to its condition.

Past audit results identified uncertainties about the completeness and existence of quantities used to produce the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because the Department often relies on weapon systems and machinery no longer in production, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Finally, work in process balances include costs related to the production or servicing of items, including direct materiel, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

1.N. Investments in U.S. Treasury Securities

The Department reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment using the effective interest rate method or another method obtaining similar results. The Department's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The Department invests in both marketable and non-marketable securities. Marketable securities are investments trading on a public market. The two types of non-marketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues non-marketable par value intragovernmental securities. Non-marketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

The Department's Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of the Military Retirement Trust Fund (MRF); Medicare-Eligible Retiree Health Care Fund (MERHCF); Other Defense Organizations General Fund (ODO GF) trust funds; donations (Gift Funds); and the USACE South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts.

1.O. General Property, Plant and Equipment

SFFAS No. 23 establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in Federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades for accounting periods beginning after September 30, 2002. The Department uses data from the Bureau of Economic Analysis to calculate a value for military equipment. .

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. Also, DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 for General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of 2 or more years. These assets remain capitalized and reported on WCF financial statements. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998.

The USACE Civil Works General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost exceeds $25,000. One exception is all buildings and structures related to hydropower projects are capitalized regardless of cost. During 2003, the Corps increased its buildings and structures threshold from $0 to $25K for all Civil Works appropriations with the exception of Revolving Fund and Power Marketing Agency assets. All Civil Works buildings and structures currently capitalized under $25,000 (excluding Revolving Fund and Power Marketing Agency) were expensed in FY 2003 and removed from the Corps of Engineers Financial Management System. Beginning in FY 2004 all Civil Works Buildings and Structures under $25,000 are expensed except for Power Marketing Agency assets.

When it is in the best interest of the government, the Department provides government property necessary to contractors to complete contract work. The Department either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, it must be reported on the Department's Balance Sheet.

The Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Department reports only the government property in the possession of contractors that is maintained in the DoD's property systems.

To bring the DoD into fuller compliance with federal accounting standards, the Department has issued new property accountability and reporting regulations that require the DoD Components to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.P. Advances and Prepayments

The Department records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. In addition, when the Department receives the related goods and services, it recognizes advances and prepayments as expenses.

1.Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), the Department records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Department records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. DoD as the lessee receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space and leases entered into by the Department in support of contingency operations are the largest components of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms, which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases. The Department expects to continue to reduce the level of owned assets while increasing the number of leased assets. The Department will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

The Department conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the Department provides financing payments. One type of financing payment that the Department makes for real property is based upon a percentage of completion. In accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in General PP&E, Net.

The Federal Acquisition Regulation allows the Department to make financing payments, under fixed price contracts. The Department reports these financing payments as "Other Assets" because the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the advance.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DoD recognizes contingencies as liabilities when past events or exchange transactions occur, a future loss is probable and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The Department's loss contingencies arise as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the Department's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the Department's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government." The Department recognizes nonenvironmental disposal liabilities for National Defense PP&E nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily separately identifiable from, environmental disposal costs.

1.T. Accrued Leave

The Department reports as liabilities civilian annual leave and military leave that has been accrued and not used as of the balance sheet date. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations represent amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represents the difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY1998, these results included the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. DoD purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. The DoD's fixed assets decrease by not renewing a treaty or not reaching agreements. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid to the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 10 percent are generally explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

The Department obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods and services not yet delivered.

1.Y. Problem Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. Intransit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance.

The Department of Defense policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. The majority of the DoD Components reported following this allocation procedure. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

1.Z. Development Fund for Iraq

On June 28, 2004, transfer of power from the Coalition Provisional Authority (CPA) to the Interim Iraqi Government (IIG) occurred. Prior to the transfer, the CPA was responsible for the management and accounting of the Development Fund for Iraq (DFI). Ongoing resolution of issues surrounding transfers of approximately $1.7 billion of DFI assets, may require additional disclosure in future financial statements.

Note 2. Nonentity Assets

As of March 31		2005		2004
1. Intragovernmental Assets				
A. Fund Balance with Treasury	$	507,368,558.58	$	854,770,036.25
B. Investments		0.00		0.00
C. Accounts Receivable		390,962.89		8,529,824.29
D. Other Assets		0.00		0.00
E. Total Intragovernmental Assets	$	507,759,521.47	$	863,299,860.54
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	$	2,016,668,299.22	$	1,508,822,943.81
B. Accounts Receivable		5,050,149,214.63		5,087,311,536.56
C. Loans Receivable		0.00		0.00
D. Inventory & Related Property		0.00		0.00
E. General PP&E		0.00		0.00
F. Investments		0.00		0.00
G. Other Assets		157,003,649.59		148,005,022.30
H. Total Nonfederal Assets	$	7,223,821,163.44	$	6,744,139,502.67
3. Total Nonentity Assets	$	7,731,580,684.91	$	7,607,439,363.21
4. Total Entity Assets	$	1,416,829,778,861.54	$	1,416,717,237,949.78
5. Total Assets	$	1,424,561,359,546.50	$	1,424,324,677,313.00

Nonentity assets are assets for which the Department maintains stewardship accountability and responsibility to report, but are not available for the Department's operation.

Fluctuations:

Nonentity Fund Balance with Treasury (FBWT) decreased a net of $347.4 million (40.6 percent). The Foreign Military Sales (FMS) Fund Balance with Treasury decreased $995.0 million due to FMS disbursements exceeding collections. The FMS Trust Fund receives funds in advance for foreign customers based on future requirement forecasts. The FMS collections from the foreign customers are based on initial deposit requirements and the billing statement that forecasts advance cash requirements. These cash collections will fluctuate based on the sales contracts. Disbursements represent the amounts expended to fulfill customer orders. The balances represent collection and disbursement activity of the current fiscal year only and are not cumulative to date. Furthermore, there are timing differences between collections and disbursements. Disbursements will exceed collections when there is a decline in new contracts with the foreign customer and also when larger initial upfront payments have been collected and disbursements are starting to catch up to collections. This decrease was offset by an increase of $538.4 million due to the reclassification of net disbursements from certain suspense accounts from nonentity to entity.

Nonentity intragovernmental accounts receivable decreased $8.1 million (95.4 percent). Erroneous balances were created during the implementation of the General Accounting and Finance System-Rehost (GAFS-R) in FY 2004 due to incorrect coding. During FY 2005 Air Force accounts receivables were reconciled and accurately recorded.

Cash and other monetary assets increased $507.9 million (33.7 percent). This increase is due to the continued support of the Operation Iraqi Freedom and Operation Enduring Freedom contingency missions totaling $506.1 million.

<u>Intragovernmental Assets</u>

Fund Balance with Treasury

The Nonentity Fund Balance with the Treasury is comprised of four elements: Iraqi Custodial Fund, Development Fund for Iraq, FMS Trust Fund, deposit and specific suspense accounts. The Iraqi Custodial Fund represents Iraqi cash seized by coalition forces during Operation Iraqi Freedom. The Development Fund for Iraq contain funds transferred from the Interim Iraqi Government to the Multi-National Force-Iraq. These funds will be used to support the Iraqi people. Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. The deposit and suspense accounts primarily represent various deposits and Thrift Saving Plan balances.

Accounts Receivable

This amount represents receivables from cancelled year appropriations. The receivables will be returned to the Treasury as miscellaneous receipts once collected.

<u>Non-Federal Assets</u>

Cash and Other Monetary Assets

Cash and other monetary assets consist of cash held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Foreign currency is valued using the Department of Treasury Prevailing Rate of Exchange.

Accounts Receivable

Receivables are primarily related to Navy General Fund advance payments made to contractors and the associated accrued interest, which remains in litigation. In addition, the United States Army Corps of Engineers reports that its non-federal nonentity accounts receivable include long-term receivables due from state and local municipalities for water storage contracts, hydraulic mining, and the leasing of land for flood control purposes. The balance of the amounts reported as nonentity non-federal accounts receivable represents accrued interest, penalties, fines and administrative fees receivable, accounts receivable due from active duty members, and accounts receivable due to cancelled year appropriations. The Department neither derives nor receives any benefit from these collections, but incurs the cost of administering them. The receivables will be returned to the Treasury as miscellaneous receipts once collected.

Other Assets

Other nonentity assets primarily represent advances to contractors by the Air Force General Fund.

Note 3. Fund Balance with Treasury

As of March 31		2005		2004
1. Fund Balances				
A. Appropriated Funds	$	444,244,757,103.93	$	475,180,550,051.22
B. Revolving Funds		8,057,367,934.48		11,358,253,639.13
C. Trust Funds		(70,368,571.94)		835,775,264.63
D. Special Funds		173,091,590.39		0.00
E. Other Fund Types		12,181,949,389.35		7,023,255,878.26
F. Total Fund Balances	$	464,586,797,446.21	$	494,397,834,833.24
2. Fund Balances Per Treasury Versus Agency				
A. Fund Balance per Treasury	$	465,228,301,886.22	$	494,189,991,183.22
B. Fund Balance per		464,586,797,446.21		494,397,834,833.24
3. Reconciling Amount	$	641,504,440.01	$	(207,843,650.02)

Reporting Entity (Amounts in millions)		Fund Balance with Treasury FY 2005		Fund Balance per Entity Books FY 2005		Reconciling Amount FY 2005		Reconciling Amount FY 2004
Navy GF	$	142,052	$	142,004	$	48	$	35
Air Force GF		116,361		116,344		17		
Army GF		120,976		120,987		(11)		
ODO GF		76,911		76,251		660		(243)
Corps of Engineers		5,110		5,183		(73)		
MERHCF		5		5				
MRF		20		20				
Air Force WCF		1,454		1,094		360		1,593
Army WCF		644		644				
ODO WCF		1,126		1,486		(360)		(1,593)
Navy WCF		569		569				
Total	**$**	**465,228**	**$**	**464,587**	**$**	**641**	**$**	**(208)**

Analysis of Reconciling Amounts

The Department of Defense shows a reconciling net difference of $641.5 million with the Department of the Treasury, which is comprised of:

- $48 million, for the Navy General Fund, that represents receipt account transactions unavailable to the Navy and treasury charges to invalid program years;
- $17 million, for the Air Force General Fund, that is primarily due to a combination of $25.4 million in allocation transfers, such as from the International Military Education and Training account and the Department of Agriculture, included in the fund balance per Treasury for Air Force but not in the fund balance per Air Force, offset by $9.1 million in funds allocated to the Department of Transportation that are included in the fund balance per Air Force but not in the fund balance per Treasury for Air Force;

- ($11) million, for the Army General Fund, which is primarily due to a combination of $66.3 million in parent account transfers and $1.5 million in Armament Retooling and Manufacturing Support reported in the fund balance per Army but not in the fund balance per Treasury for Army offset by $56.9 million in allocation transfers reported in the fund balance per Treasury for Army but not in the fund balance per Army;
- $660 million, for the Other Defense Organizations (ODO) General Fund, that primarily consists of the net of a positive reconciling difference of $62.1 million for the DoD component level accounts offset by the aggregated negative reconciling difference of approximately 50 other defense organizations;
- ($73) million that primarily consists of approximately $73 million included in the fund balance per U.S. Army Corps of Engineers but not in its fund balance per Treasury. The U.S. Army Corps of Engineers is the lead agency for reporting the funding of the Inland Waterways and Harbor Maintenance Trust Funds;
- $360 million, for the Air Force Working Capital Fund, that represents the $360 million for the United States Transportation Command which is reported to the Treasury as part of the Air Force Working Capital Fund. The accounting for these funds is actually performed within the entity books of the ODO Working Capital Fund. For financial reporting, the Fund Balance with Treasury for the ODO Working Capital Fund is adjusted downward to reconcile with the Air Force Working Capital Fund;
- ($360) million, for the ODO Working Capital Fund, which is primarily due to the downward adjustment to the Fund Balance per Treasury for the ODO Working Capital Fund to reflect that the cash reporting to the Department of the Treasury for the United States Transportation Command is done through the Air Force Working Capital Fund.

4. Other Information Related to Fund Balance with Treasury

Total Fund Balance

Total Fund Balance with Treasury per Department of Defense decreased, between 2nd Quarter, FY 2004 and 2nd Quarter, FY 2005, by approximately $29.8 billion (6 percent).

Appropriated Funds decreased by approximately $30.9 billion (7 percent). This was primarily as a result of decreased budget authority in FY 2005 for the Army and Air Force General Funds. Between 2nd Quarter, FY 2004 and 2nd Quarter, FY 2005, Army General Funds decreased by approximately $19.3 billion and Air Force General Funds decreased by approximately $6.2 billion. The decreases are primarily attributable to the reduced funding received because the supplemental funding for military missions under Operation Enduring Freedom and Operation Iraqi Freedom has not been received in FY 2005.

The Army General Fund includes approximately $36.3 million in Vested Iraqi Cash. This cash represents frozen Iraqi deposits in the United States and is vested in accordance with the International Emergency Economic Powers Act, Section 1701, and is used in support of the Iraqi people. Army has collected $1,724.1 million in Vested Iraqi Cash and has disbursed $1,687.8 million benefiting the Iraqi people as follows:

	Disbursed ($ in millions)
Iraqi Salaries	$1,184.8
Repair/Reconstruction/Humanitarian Assistance	$ 143.0
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	$ 360.0
Total Disbursed	$1,687.8

Defense Wide

The Revolving Funds decreased by approximately $3.3 billion (29 percent). This change was primarily a result of decreases to the Army Working Capital Fund, the Other Defense Organizations Working Capital Fund and the Pentagon Reservation Maintenance Revolving Fund. The Army Working Capital Fund decreased approximately $1.2 billion. This change was primarily due to several reprogramming actions during 3rd and 4th Quarters FY 2004 for $1.3 billion. The Other Defense Organizations Working Capital Fund decreased by approximately $1.7 billion. The Air Mobility Command component of the U.S. Transportation Command contributed $1.2 billion of the decrease, primarily as a result of reprogramming actions. The Pentagon Reservation Maintenance Revolving Fund decreased by approximately $400 million, primarily attributable to the level of expenditures.

The Trust Funds decreased by approximately $906.1 million (108 percent) primarily due to a reduction of $961.4 in the Other Defense Organizations (ODO) General Fund. Within the ODO General Fund, the Foreign Military Trust Fund's current year disbursements exceeded current year collections by approximately $800 million. The reduction was offset by an increase of approximately $73 million in the US Army Corps of Engineers' (USACE) Harbor Maintenance and Inland Waterways Trust Funds. The USACE is the lead agency for reporting these trust funds.

Special Funds increased by approximately $173.1 million. Special Funds is a new category of Fund Type. Amounts reported in this category were previously reported in one of the other four categories.

The Other Fund Types increased by approximately $5.2 billion (74 percent) primarily as a result of the $4.8 billion increase in the Army General Fund's Iraqi Relief and Reconstruction Fund. There was also an increase of approximately $497 million in the Navy General Fund primarily due to efforts in clearing negative balances in the Disbursing Officers and Interfund/IPAC suspense accounts.

During FY 2003 and subsequently through the 1st Quarter, FY 2005, the non-entity seized (Custodial) Iraqi cash had collections of $927.2 million and disbursements of $844.1 million resulting in the balance of $83.1 million (See Note 22). The Iraqi seized cash will be used in support of the Iraqi people. In addition, during FY 2005 the Army General Fund received a deposit of $112 million from the Interim Iraqi Government into the Development Fund for Iraq (DFI). These funds will be accounted for separately from the seized Iraqi cash.

Status of Fund Balance with Treasury

As of March 31		2005		2004
1. Unobligated Balance				
A. Available	$	439,430,170,795.39	$	464,955,877,530.11
B. Unavailable		71,815,221,625.22		53,541,409,141.99
2. Obligated Balance not yet Disbursed	$	(46,487,680,432.91)	$	(23,642,256,476.28)
3. Total	$	464,757,711,987.70	$	494,855,030,195.82

The Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed and other authorizations (i.e. contract authority, restricted invested balances).

Fluctuations and/or Abnormalities

Status of Fund Balance with Treasury balances decreased $30.1 billion (6 percent). The decrease is attributable to a combination of a $25.5 billion decrease in Unobligated Balance Available, a $18.3 billion increase of Unobligated Balance Unavailable, and a $22.9 billion decrease in Obligated Balance not yet Disbursed.

The decrease of Unobligated Balance Available directly corresponds to a decrease in appropriations received by the Department of Defense in FY 2005. The increase of $18.3 billion (34 percent) in Unobligated Balance Unavailable was primarily due to the Medicare Eligible Retiree Health Care Fund's (MERHCF) Unapportioned Authority increase of $22.2 billion. This increase is partially offset by reduction of expired authority of $3.9 billion.

Obligated Balance not yet Disbursed decreased by a net of $22.9 billion. The decrease is a result of a decrease of $30.6 billion in restricted invested balances, a decrease of $3.7 billion in contract authority, and an increase of $11.5 billion in unpaid undelivered orders and unfilled customer orders. The increase in the $11.5 billion unpaid undelivered orders is related to the supplemental appropriation received in August 2004 for Operation Iraqi Freedom. Obligated Balance not yet Disbursed shows an abnormal balance because the investments included in the unobligated balance were backed out of the Obligated Balance not yet disbursed. Investments were removed because they do not contribute to FBWT. A correction to presentation is planned for third quarter.

For FY 2005 and subsequent reporting for both these financial statements and the accompanying budgetary data, the Office of Management and Budget has determined that amounts appropriated but not yet apportioned for current quarter use by the Department are to be reclassified as available vice unavailable. This will create significant but offsetting differences in the amounts classified as an Unobligated Balance during this initial year of change.

Disclosures Related to Suspense/Budget Clearing Accounts

As of March 31	2003	2004	2005	(Decrease)/ Increase from FY 2004 - 2005
Account				
F3875	$ 55,880,383.22	$ 363,125,624.42	$ 202,578,790.40	$ (160,546,834.02)
F3880	(20,267,423.69)	(8,264,541.26)	23,354,045.06	31,618,586.32
F3882	11,021,477.57	5,276,529.59	62,132,593.37	56,856,063.78
F3885	(663,957,395.43)	(530,788,373.64)	(186,192,079.10)	344,596,294.54
F3886	6,046,492.30	194,641.80	270,133.49	75,491.69
Total	$ (611,276,466.03)	$ (170,456,119.09)	$ 102,143,483.22	$ 272,599,602.31

A description of the suspense and budget clearing accounts and their respective balances follows:

The F3875 suspense clearing account represents the primary source of the overall positive balance. Account F3875 reported a positive balance of approximately $202.6 million that represents the Disbursing Officer's (DO) suspense. Account F3885, that includes the Interfund/IPAC suspenses, reported a negative balance of approximately $186.2 million. Account F3886 has a positive balance of approximately $.3 million represented by the (payroll) Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account reported a positive balance of approximately $23.4 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

The F3882 suspense account reported a positive balance of approximately $62.1 million. This account was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these same amounts in the military accounting systems in the following month.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of March 31	2003	2004	2005	(Decrease)/ Increase from FY 2004 - 2005
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDS)	$ 1,662,712,735.61	$ 1,505,151,989.83	$ 5,858,819,554.80	$ 4,353,667,564.97
B. Negative Unliquidated Obligations (NULO)	207,950,894.50	166,241,673.78	187,114,922.90	20,873,249.12
2. Total In-transit Disbursements, Net	$ 6,258,630,453.29	$ 6,212,596,964.71	$ 5,032,141,594.27	$ (1,180,455,370.44)

The DoD reported $5.9 billion (absolute value) in Unmatched Disbursements (UMD), which is an increase of $4.3 billion. A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

The DoD reported $187.1 million (absolute value) in Negative Unliquidated Obligations (NULOs), which is an increase of $20.9 million. A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These problem disbursements represent the absolute value of disbursements of DoD funds that have been reported by a disbursing station to the Department of the Treasury. However, these problem disbursements have not yet been precisely matched against the specific source obligation that gave rise to the disbursements. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The DoD reported $5.0 billion (net) for In-Transits, which is a decrease of $1.2 billion. The In-Transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

The elimination of both problem disbursements and aged in-transits is one of the highest financial management priorities of the Under Secretary of Defense (Comptroller). The DFAS has efforts underway to improve the systems, resolve all previous problem disbursements, and to process all in-transit disbursements in a timely manner.

Note 4. Investments and Related Interest

As of March 31	2005					2004
	Par Value/Cost	Amortization Method	Unamortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
1. Intragovernmental Securities						
A. Non-Marketable, Market-Based	$ 253,955,132,194.15	Effective Interest	$ 7,922,477,342.30	$ 261,877,609,536.45	$ 268,412,267,310.39	$ 231,392,888,398.10
B. Accrued Interest	3,564,164,329.70			3,564,164,329.70	3,564,164,329.70	3,868,706,743.21
C. Total Intragovernmental Securities	$ 257,519,296,523.85		$ 7,922,477,342.30	$ 265,441,773,866.15	$ 271,976,431,640.09	$ 235,261,595,141.31
2. Other Investments	$ 502,593,130.00		0.00	$ 502,593,130.00	N/A	$ 378,050,630.00

The amortization method used for non-marketable, market-based securities is effective interest. Other Investments represent limited partnerships, entered into on behalf of the U.S. Government by the Army and Navy in support of the Military Housing Privatization Initiative authorized by Public Law 104-106, Stat. 186, on February 11, 1996. These investments do not require market value disclosure.

Intragovernmental Securities

Net Investments increased by $30.2 billion (13 percent) in non-marketable, market-based securities. The increase is primarily due to positive cash flows of $20.3 billion for the Medicare-Eligible Retiree Health Care Fund, $9.6 billion for the Military Retirement Fund, and $0.3 billion for the Army General Fund.

Other Investments

Other Investments increased $124.5 million (33 percent) due to new investments in limited partnerships by the Army ($65.0 million) and Navy ($59.5 million) to support military housing. A summary of the Department's total investments in these limited partnerships follows:

Defense Wide

INSTALLATION	Q2 FY 2004 BALANCE	MONTH INVESTED	NEW INVESTMENTS	MONTH INVESTED	Q2 FY 2005 TOTAL
Beaufort/Paris ISL/Quantico	$ 97,158	Oct-03			$ 97,158
Ft. Campbell, Kentucky *	52,205	Jan-04	7,900	Mar-04	60,105
Ft. Hood, Texas	52,000	Nov-03			52,000
Ft. Bragg, North Carolina	49,437	Dec-03			49,437
Ft. Stewart, Georgia	37,374	Feb-04		Feb-04	37,374
South Texas, Texas	29,400	Feb-02			29,400
New Orleans Naval Complex, Louisiana	23,100	Oct-01			23,100
San Diego, California	20,900	Jun-03			20,900
Everett NAS, Washington	12,176	Dec-00			12,176
Kingsville NAS, Texas	4,300	Dec-00			4,300
Ft. Hamilton, New York *			2,175	May-04	2,175
Ft. Detrick, Maryland *			1,285	Sep-04	1,285
Ft/. Polk, Louisiana *			53,655	Feb-05	53,655
Oahu, Hawaii**			25,000	May-04	25,000
Yuma Naval Air Station **			18,654	Dec-04	18,654
Pacific Northwest **			15,874	Mar-05	15,874
TOTALS	$ 378,050		$ 124,543		$ 502,593

*Army Installations

**Navy Installations

Note 5. Accounts Receivable

As of March 31	2005			2004
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 1,883,143,080.15	N/A	$ 1,883,143,080.15	$ 1,343,609,003.43
2. Nonfederal Receivables (From the Public)	$ 7,554,081,243.25	$ (295,298,889.29)	$ 7,258,782,353.96	$ 6,834,909,094.11
3. Total Accounts Receivable	$ 9,437,224,323.40	$ (295,298,889.29)	$ 9,141,925,434.11	$ 8,178,518,097.54

Total accounts receivable, net, increased $963.0 million (12 percent). Nonfederal receivables increased $423.9 million (6 percent).

Intragovernmental receivables increased $539.5 million (40 percent), which is primarily attributable to the U.S. Army Corps of Engineers (USACE). The USACE receivables increased $443.5 million due to reimbursable work performed for the Federal Emergency Management Agency (FEMA) to support the 2004 hurricanes. This support began in 4th Quarter, FY 2004 and has continued through 2nd Quarter, FY 2005. Other increases include $82.1 million that is to be transferred from the Aquatic Resources Trust Fund (Department of Interior) and $55.5 million to be transferred from the Inland Waterways Trust Fund for inland waterway navigation dredging and erosion prevention projects. In addition, the Air Force General Fund improved training to personnel responsible for recording goods and services provided to other organizations. This action resulted in a greater number of reimbursable transactions recorded with other federal agencies.

Note 6. Other Assets

As of March 31	2005	2004
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 1,065,241,743.51	$ 144,043,522.36
B. Total Intragovernmental Other Assets	$ 1,065,241,743.51	$ 144,043,522.36
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 21,878,131,196.41	$ 20,205,317,261.04
B. Other Assets (With the Public)	2,832,715,525.17	2,943,510,079.42
C. Total Nonfederal Other Assets	$ 24,710,846,721.58	$ 23,148,827,340.46
3. Total Other Assets	$ 25,776,088,465.09	$ 23,292,870,862.82

Fluctuations

Intragovernmental Other Assets

Advances and Prepayments increased $921.2 million (640 percent). The increase is primarily attributed to the General Funds of the Army, Air Force, and Navy which experienced increases of $359.7 million, $77.1 million, and $529.1 million, respectively. The increase results from business processes established in FY 2004 to record government advances with other non-DoD government entities that are procuring goods and services for the Department of Defense. The account balance is based on either accruals or estimation techniques.

Nonfederal Other Assets

Outstanding Contract Financing Payments

The Department reports all outstanding financing payments for fixed-price contracts that are not based on percentage or stage of completion. Under the contract terms, the Department becomes liable only if the contractor delivers the goods in conformance with the contract. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the outstanding contract financing payments.

Note 7. Cash and Other Monetary Assets

As of March 31		2005		2004
1. Cash	$	1,685,095,040.70	$	1,442,276,517.34
2. Foreign Currency (non-purchased)		479,504,005.13		216,912,862.02
3. Total Cash, Foreign Currency, & Other Monetary Assets	$	2,164,599,045.83	$	1,659,189,379.36

Fluctuations and/or Abnormalities

Cash increased by $242.8 million (17 percent) and foreign currency increased by $262.6 million (121 percent), resulting in a total increase of $505.4 million (30 percent) in Cash, Foreign Currency, and Other Monetary Assets. The increase in cash is primarily due to the Army's support of Operation Iraqi Freedom and Operation Enduring Freedom. Other increases are due to the Marine Corps depositing money into its Limited Depositary Account to hold disbursing officer cash in foreign currencies for deployment and mission requirements.

Other Information

The majority of cash and all foreign currency are classified as nonentity and its use is, therefore, restricted. Approximately $1.5 billion in cash and $479.5 million in foreign currency are restricted.

Note 8. Direct Loan and/or Loan Guarantee Programs

As of March 31

Direct Loan and/or Loan Guarantee Programs The entity operates the following direct loan and/or Loan guarantee program(s)

Military Housing Privatization Initiative
Armament Retooling & Manufacturing Support Initiative

The Federal Credit Reform Act (FCRA) of 1990 governs direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

Direct loans are reported at the net present value of the following projected cash flows:

- Loan disbursements;
- Repayments of principal; and
- Payments of interest and other payments over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties and other recoveries

Loan guarantee liabilities are reported at the net present value. The cost of the loan guarantee is the net present value of the following estimated projected cash flows:

- Payments by the Department to cover defaults and delinquencies, interest subsidies, or other payments; offset by
- Payments to the Department including origination and other fees, penalties, and recoveries.

Military Housing Privatization Initiative

The Military Housing Privatization Initiative (MHPI) includes both Direct Loan and Loan Guarantee Programs. The Department obtains private sector capital to leverage government dollars. The Department provides protection against specific risks, such as base closure or member deployment, for the private sector partner. The Direct Loan and Loan Guarantee Programs are authorized by the National Defense Authorization Act for FY 1996, Public Law (P.L.) 104-106 Statute 186, Section 2801.

Armament Retooling and Manufacturing Support Initiative

The Armament Retooling and Manufacturing Support Initiative (ARMS), Title 10 USC 4551-4555, is a Loan Guarantee Program designed to encourage commercial use of the Army's Inactive Ammunition Plants through many incentives for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements however; this capacity may be needed by the military in the future. The revenues from the property rental are used to pay for the operation, maintenance and environmental clean up at the facilities. The resulting savings in overhead costs lower the production cost of the goods manufactured and fund environmental clean up at no cost to the government.

The Department had no defaulted guaranteed loans as of March 31, 2005.

Administrative Expense is limited to separately identified expenses administered to direct and guaranteed loans. DoD does not maintain a separate program to capture the expenses related to direct and guaranteed loans only for the MHPI.

Administrative Expense for the ARMS is a fee paid to the US Department of Agriculture Rural Business Service for administering the loan guarantees under the ARMS, which is a joint program. Administrative Expense for the ARMS is immaterial to the DoD financial statements.

Direct Loans Obligated After FY 1991

As of March 31	2005	2004
Loan Programs		
Military Housing Privatization Initiative		
A. Loans Receivable Gross	$ 141,444,060.26	$ 141,479,978.20
B. Interest Receivable	1,900,932.47	0.00
C. Foreclosed Property	0.00	0.00
D. Allowance for Subsidy Cost (Present Value)	(70,721,790.27)	(74,409,923.10)
E. Value of Assets Related to Direct Loans	$ 72,623,202.46	$ 67,070,055.10
Total Loans Receivable	$ 72,623,202.46	$ 67,070,055.10

Subsidy costs are recognized when direct loans are disbursed to borrowers and are re-estimated each year as of the date of the financial statements. Interest receivables related to direct loans were not previously reported. The allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash flows. The decrease in the allowance for subsidy is the result of FY 2004 subsidy reestimates, subsidy amortization and an adjustment to FY 2004 subsidy expense. Interest subsidy amortization is the net of interest revenue and interest expense. The subsidy represents the difference between net borrowing from Treasury and gross loans receivable.

Gross direct loans disbursed for the MHPI program from inception consists of the following:

	(in millions)
Dyess Air Force Base, Texas	$ 28.9
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	10.6
Warner Robins Air Force Base, Georgia	22.3
Camp Pendleton Marine Corps Base, California	29.4
Kingsville Air Force Base, Texas	2.5
Total	**141.7**
Less: Previous Principal Repayments	(0.3)
Loans Receivable Gross	$ **141.4**

Total Amount of Direct Loans Disbursed

As of March 31	2005	2004
Direct Loan Programs		
Military Housing Privatization Initiative	$ 0.00	$ 12,396,000.00
Total	$ 0.00	$ 12,396,000.00

The Department disbursed no new direct loans in the current fiscal year.

Subsidy Expense for Post-1991 Direct Loans

As of March 31

2005	Interest Differential	Defaults	Fees	Other	Total
1. New Direct Loans Disbursed: Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2004	Interest Differential	Defaults	Fees	Other	Total
2. New Direct Loans Disbursed: Military Housing Privatization Initiative	$ 7,227,282.64	$ 538,503.48	$ 0.00	$ 0.00	$ 7,765,786.12

2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Direct Loan Modifications and Reestimates: Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2004	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Direct Loan Modifications and Reestimates: Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

	2005	2004
5. Total Direct Loan Subsidy Expense: Military Housing Privatization Initiative	$ 0.00	$ 7,765,786.12

The interest rate and default cost values represent the amounts for the loans disbursed in FY 2005. These rates are established for each fiscal year the loan agreement was made. Interest rate reestimate for subsidy cost is an adjustment to subsidy cost from the assumed interest rates used in the budget preparations to the interest rates that are applicable to the periods in which the loans are disbursed. Technical/default reestimate is an adjustment to subsidy cost based on the latest projections of defaults, delinquencies, recoveries, prepayments or other cash flow components.

The Department disbursed no new direct loans in current fiscal year.

The Armament Retooling and Manufacturing Support Initiative does not issue direct loans.

Defense Wide

Subsidy Rate for Direct Loans

As of March 31	Interest Differential	Defaults	Fees	Other	Total
Military Housing Privatization Initiative	14.28%	11.06%	0.00%	0.00%	25.34%

Subsidy rates pertain to the loan agreements contracted during the current fiscal year. The subsidy expense for new loans disbursed in the current year could result from disbursement of loans from both current and prior-year loan agreements.

The subsidy rates are published annually by the Office of Management and Budget (OMB).

Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans

As of March 31	2005	2004
1. Beginning Balance of the Subsidy Cost Allowance	$ 70,721,790.27	$ 65,118,683.98
2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
A. Interest Rate Differential Costs	$ 0.00	$ 7,227,282.64
B. Default Costs (Net of Recoveries)	0.00	538,503.48
C. Fees and Other Collections	0.00	0.00
D. Other Subsidy Costs	0.00	0.00
E. Total of the above Subsidy Expense Components	$ 0.00	$ 7,765,786.12
3. Adjustments		
A. Loan Modifications	$ 0.00	$ 0.00
B. Fees Received	0.00	0.00
C. Foreclosed Property Acquired	0.00	0.00
D. Loans Written Off	0.00	0.00
E. Subsidy Allowance Amortization	0.00	0.00
F. Other	0.00	1,525,453.00
G. Total of the above Adjustment Components	$ 0.00	$ 1,525,453.00
4. Ending Balance of the Subsidy Cost Allowance before Re-estimates	$ 70,721,790.27	$ 74,409,923.10
5. Add or Subtract Subsidy Re-estimates by Component		
A. Interest Rate Re-estimate	$ 0.00	$ 0.00
B. Technical/default Re-estimate	0.00	0.00
C. Total of the above Re-estimate Components	$ 0.00	$ 0.00
6. Ending Balance of the Subsidy Cost Allowance	$ 70,721,790.27	$ 74,409,923.10

Guaranteed Loans Outstanding

As of March 31	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding		
1. Military Housing Privatization Initiative	$ 554,020,000.00	$ 554,020,000.00
2. Armament Retooling & Manufacturing Support Initiative	$ 27,561,517.03	$ 24,701,455.66
3. Total	$ 581,581,517.03	$ 578,721,455.66
2005		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	$ 165,000,000.00	$ 165,000,000.00
2. Armament Retooling & Manufacturing Support Initiative	$ 0.00	$ 0.00
3. Total	$ 165,000,000.00	$ 165,000,000.00
2004		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	$ 0.00	$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	$ 0.00	$ 0.00
3. Total	$ 0.00	$ 0.00

The Guaranteed Loans Outstanding for the MHPI program as of the end of March 31, 2005 consists of the following:

	(in millions)
Warner-Robins Air Force Base, Georgia	$ 25.6
Fort Carson Army Installation, Colorado	147.0
Kirtland Air Force Base, New Mexico	74.0
Wright-Patterson Air Force Base, Ohio	65.0
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	29.4
Fort Polk, Louisiana	165.0
Total	$ **554.0**

Liability for Post-1991 Loan Guarantees, Present Value		
As of March 31	2005	2004
Loan Guarantee Program		
1. Military Housing Privatization Initiative	$ 33,466,807.32	$ 21,543,648.98
2. Armament Retooling & Manufacturing Support Initiative	12,352,470.32	1,272,636.32
3. Total	$ 45,819,277.64	$ 22,816,285.30

MHPI
The $11.9 million (55%) increase is attributable to the subsidy expense for the new guarantee loans issued for Fort Polk, and changes in actual loan performance in FY 2004. For additional information, see the Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees. There was one new guaranteed loan added in FY 2005.

ARMS

Total loan guarantee liabilities increased $11.1 million (871%) due to changes in actual loan performance in FY 2004. There were no new guaranteed loans added in FY 2005.

Subsidy Expense for Post-1991 Loan Guarantees

As of March 31

2005	Interest Differential	Defaults	Fees	Other	Total
1. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 10,345,500.00	$ 0.00	$ 0.00	$ 10,345,500.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 10,345,500.00	$ 0.00	$ 0.00	$ 10,345,500.00

2004	Interest Differential	Defaults	Fees	Other	Total
2. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2004	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

	2005	2004
5. Total Loan Guarantee:		
Military Housing Privatization Initiative	$ 10,345,500.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00
Total	$ 10,345,500.00	$ 0.00

MHPI

The increase in the reporting of Interest Rate Differential Costs and Default Costs is proportional to the number of loans guaranteed.

ARMS

ARMS had no new loan guarantees in FY 2005.

Subsidy Rate for Loan Guarantees

	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees:					
1. Military Housing Privatization Initiative	0.00%	9.65%	0.00%	0.00%	9.65%
2. Armament Retooling & Manufacturing Support Initiative	0.00%	3.75%	-1.79%	0.00%	1.96%

The subsidy rates disclosed pertain only to loan agreements made during the current fiscal year. The subsidy expense for new loans reported in the current year result from disbursements of loans from both current year loan agreements and prior year(s) loan agreements. The subsidy expense reported in the current year also includes modifications and re-estimates.

The subsidy rates are published annually by OMB.

Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees

As of March 31		2005		2004
1. Beginning Balance of the Loan Guarantee Liability	$	34,360,030.64	$	25,839,301.30
2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component				
A. Interest Supplement Costs	$	0.00	$	0.00
B. Default Costs (Net of Recoveries)		10,345,500.00		0.00
C. Fees and Other Collections		0.00		0.00
D. Other Subsidy Costs		0.00		0.00
E. Total of the above Subsidy Expense Components	$	10,345,500.00	$	0.00
3. Adjustments				
A. Loan Guarantee Modifications	$	0.00	$	0.00
B. Fees Received		59,500.00		0.00
C. Interest Supplements Paid		0.00		0.00
D. Foreclosed Property and Loans Acquired		0.00		0.00
E. Claim Payments to Lenders		0.00		0.00
F. Interest Accumulation on the Liability Balance		1,054,247.00		0.00
G. Other		0.00		(3,023,016.00)
H. Total of the above Adjustments	$	1,113,747.00	$	(3,023,016.00)
4. Ending Balance of the Loan Guarantee Liability before Re-estimates	$	45,819,277.64	$	22,816,285.30
5. Add or Subtract Subsidy Re-estimates by Component				
A. Interest Rate Re-estimate		0.00		0.00
B. Technical/default Re-estimate		0.00		0.00
C. Total of the above Re-estimate Components	$	0.00	$	0.00
6. Ending Balance of the Loan Guarantee Liability	$	45,819,277.64	$	22,816,285.30

Administrative Expense is limited to separately identified expenses administered to direct and guaranteed loans. DoD does not maintain a separate program to capture the expenses related to direct and guaranteed loans only for the MHPI.

Administrative Expense for the ARMS is a fee paid to the US Department of Agriculture Rural Business Service for administering the loan guarantees under the ARMS, which is a joint program. Administrative Expense for the ARMS is immaterial to the DoD financial statements.

Note 9. Inventory and Related Property

As of March 31	2005	2004
1. **Inventory, Net**	$ 67,831,328,674.32	$ 71,068,496,297.54
2. **Operating Materials & Supplies, Net**	140,042,543,165.50	141,469,390,838.28
3. **Stockpile Materials, Net**	1,391,420,715.98	1,667,420,516.91
4. **Total**	$ 209,265,292,555.80	$ 214,205,307,652.73

Inventory, Net

As of March 31

	2005			2004	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
1. Inventory Categories					
A. Available and Purchased for Resale	$ 76,165,928,558.30	$ (34,993,530,408.70)	41,172,398,149.60	$ 46,220,511,827.48	LAC,MAC
B. Held for Repair	31,142,101,548.58	(5,347,082,956.31)	25,795,018,592.27	23,561,701,521.19	LAC,MAC
C. Excess, Obsolete, and Unserviceable	6,254,494,031.63	(6,254,494,031.63)	0.00	0.00	NRV
D. Raw Materials	28,552,365.95	0.00	28,552,365.95	21,705,022.25	MAC,SP,LAC
E. Work in Process	835,359,566.50	0.00	835,359,566.50	1,264,577,926.62	AC
F. Total	$ 114,426,436,070.96	$ (46,595,107,396.64)	67,831,328,674.32	$ 71,068,496,297.54	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for and losses holding gains and losses
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
O = Other
MAC = Moving Average Cost

Generally, there are no restrictions on the use, sale, or disposition of inventory except in the following situations:

- Distributions without reimbursement are made when authorized by Department of Defense directives.
- War reserve materiel includes fuels and subsistence items that are considered restricted.
- Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with the current policies and guidance or at the direction of the President.

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, and fuels held for sale by the Defense Working Capital Funds. Inventory is tangible personal property that is:

- Held for sale, or held for repair for eventual sale;
- In the process of production for sale; or
- To be consumed in the production of goods for sale or in the provision of service for a fee.

Fluctuations

Inventory Available and Purchased for Resale decreased $5.0 billion (11 percent). The predominate reason for the decrease was due to two events recorded by the Air Force Working Capital Fund: (1) A decrease of $4.9 billion related to price corrections for in-transit inventory, and (2) A decrease of $1.6 billion due to an erroneous understatement of the inventory valuation allowance.

Raw Material increased $6.9 million (32 percent). The increase is due to the Tobyhanna Army Depot's conversion to the Logistics Modernization Program. As a result of the conversion, raw materials were separated from inventory available and purchased for resale.

Defense Wide

Work in Process decreased $429.2 million (34 percent). The decrease is the result of the closeout of the Conventional Ammunition Working Capital Fund and the continued phase out of the Contract Depot Maintenance Activity Group operations. In addition, the Aviation Depots' Component program is in the process of implementing new revenue recognition procedures to recognize revenue as a percentage of work completed.

Operating Materials and Supplies, Net

As of March 31	2005			2004	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
1. OM&S Categories					
A. Held for Use	$ 124,758,437,191.84	$ 0.00	$ 124,758,437,191.84	$ 125,732,536,959.05	SP, LAC
B. Held for Repair	17,414,380,837.83	(2,130,274,864.17)	15,284,105,973.66	15,736,853,879.23	SP, LAC
C. Excess, Obsolete, and Unserviceable	3,489,159,005.10	(3,489,159,005.10)	0.00	0.00	NRV
D. Total	$ 145,661,977,034.77	$ (5,619,433,869.27)	$ 140,042,543,165.50	$ 141,469,390,838.28	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost adjusted for holding gains and losses
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
O = Other

General Composition of Operating Materials and Supplies

Operating Materials and Supplies include spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines held for consumption by General Funds. Generally, there are no restrictions on the use or disposition of operating materials and supplies.

Stockpile Materials, Net

As of March 31	2005			2004	
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method
1. Stockpile Materials Categories					
A. Held for Sale	$ 1,297,334,947.03	$ 0.00	$ 1,297,334,947.03	$ 1,532,690,710.72	AC, LCM
B. Held in Reserve for Future Sale	94,085,768.95	0.00	94,085,768.95	134,729,806.19	AC, LCM
C. Total	$ 1,391,420,715.98	$ 0.00	$ 1,391,420,715.98	$ 1,667,420,516.91	

Legend for Valuation Methods:

LAC = Latest Acquisition Cost
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
LCM = Lower of Cost or Market
O = Other

General Composition of Stockpile Materials

Stockpile materials are strategic and critical materials, held due to statutory requirements, for use in national defense, conservation or national emergencies. All materials held by the Defense National Stockpile (DNS) are classified as Material Held in Reserve until congressional action declares the materials are no longer required to be stockpiled, and are available for sale on the open market. When DNS receives authorization to offer materials for sale, DNS removes the materials from Material Held in Reserve and reclassifies them as Materials Held for Sale. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained and (4) as authorized by law.

Fluctuations:

Materials Held for Sale decreased $235.4 million (15 percent). The decrease is due to the National Defense Stockpile Center's aggressive disposal program to meet inventory reduction targets. The type and quantity of each commodity chosen for sale in a fiscal year is based on statutory sales authority and on the Annual Material Plan (AMP). This plan has been approved by the Market Impact Committee and submitted to Congress in accordance with section 11(b) of the Strategic and Critical Materials Stockpiling Act (50 U.S.C. 98h-2(b)). As a result, significant commodities to include lead, zinc, and titanium were sold to the public.

Materials Held in Reserve for Future Sale decreased $40.6 million (30 percent). The decrease was a due to a National Defense Stockpile Center's correction of a systems programming error in FY 2005.

Note 10. General PP&E, Net

As of March 31	2005					2004
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
1. Major Asset Classes						
A. Land	N/A	N/A	$ 10,390,116,229.99	N/A	$ 10,390,116,229.99	$ 9,650,650,940.01
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,196,864,764.89	$ (92,593,998,881.84)	66,602,865,883.05	69,004,244,536.74
C. Leasehold Improvements	S/L	lease term	136,141,128.23	(99,184,231.88)	36,956,896.35	45,356,241.35
D. Software	S/L	2-5 Or 10	6,231,689,706.02	(3,811,151,631.51)	2,420,538,074.51	2,204,005,484.52
E. General Equipment	S/L	5 or 10	62,159,747,947.66	(44,946,020,088.90)	17,213,727,858.76	13,769,734,898.98
F. Military Equipment	S/L	Various	1,168,970,000,000.00	(838,480,000,000.00)	330,490,000,000.00	331,350,000,000.00
G. Assets Under Capital Lease	S/L	lease term	635,335,112.71	(433,484,268.70)	201,850,844.01	229,763,252.12
H. Construction-in-Progress	N/A	N/A	20,175,722,189.89	N/A	20,175,722,189.89	20,520,958,412.68
I. Other			80,898,192.69	(3,009,768.45)	77,888,424.24	109,526,894.49
2. Total General PP&E			$ 1,427,976,515,272.10	$ (980,366,848,871.28)	$ 447,609,666,400.80	$ 446,884,240,660.89

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

S/L = Straight Line N/A = Not Applicable

General Property, Plant and Equipment (PP&E) increased $725.2 million (0.2 percent).

Assets Under Capital Lease

As of March 31	2005	2004
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	$ 625,335,565.05	$ 576,203,434.43
B. Equipment	9,999,547.66	1,163,847.69
C. Other	0.00	0.00
D. Accumulated Amortization	(433,484,268.70)	(347,604,030.00)
E. Total Capital Leases	$ 201,850,844.01	$ 229,763,252.12

Assets Under Capital Lease consist primarily of leases for the Section 801 Family Housing Program.

Note 11. Liabilities Not Covered by Budgetary Resources

As of March 31	2005	2004
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0.00	$ 0.00
B. Debt	14,611,353.81	16,654,014.16
C. Other	6,961,373,367.34	4,638,594,329.33
D. Total Intragovernmental Liabilities	$ 6,975,984,721.15	$ 4,655,248,343.49
2. Nonfederal Liabilities		
A. Accounts Payable	$ 328,796,026.29	$ 3,211,028.00
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,295,240,126,409.47	1,182,900,399,249.33
C. Environmental Liabilities	61,326,752,489.62	57,475,162,404.78
D. Loan Guarantee Liability	0.00	0.00
E. Other Liabilities	13,641,885,818.04	13,628,469,810.21
F. Total Nonfederal Liabilities	$ 1,370,537,560,743.40	$ 1,254,007,242,492.30
3. Total Liabilities Not Covered by Budgetary Resources	$ 1,377,513,545,464.60	$ 1,258,662,490,835.80
4. Total Liabilities Covered by Budgetary Resources	$ 328,414,731,636.08	$ 299,317,065,159.02
5. Total Liabilities	$ 1,705,928,277,100.70	$ 1,557,979,555,994.80

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the Balance Sheet date. For additional disclosures, see Note 17 for Military Retirement Benefits and Other Employment Related Actuarial Liabilities and Note 14 for Environmental Liabilities.

Fluctuations

Intragovernmental Debt

Debt decreased $2.1 million (13 percent) as a result of debt reduction payments by the U.S. Army Corps of Engineers (USACE) and U.S. Transportation Command (TRANSCOM) of $0.8 million and $1.2 million, respectively. The USACE debt payment is an installment payment on a loan for capital improvements to the Washington Aqueduct. The remaining USACE unfunded debt is $14.6 million. The $1.2 million payment was the final payment for a Military Sealift Command (MSC) loan from the Federal Financing Bank. MSC, who is a TRANSCOM element, made the final loan payment in July 2004.

Intragovernmental – Other

Intragovernmental Liabilities - Other increased $2.3 billion (50 percent). The USACE and the USAF changed the reporting classification of funds held for others from entity to non-entity assets and the corresponding liabilities from Liabilities Covered by Budgetary Resources to Liabilities Not Covered by Budgetary Resources. The USACE's reclassification was
$1.8 billion and the USAF's was $545 million.

Defense Wide

Nonfederal Accounts Payable

Nonfederal Accounts Payable increased $325.6 million (10,175 percent). This variance is the result of a reclassification of Accounts Payable from Cancelled Appropriations from Nonfederal Other Liabilities to Accounts Payable to correctly reflect Treasury guidance. This change took place in the third quarter of FY 2004.

Military Retirement Benefits and Other Employment Related Actuarial Liabilities

The reported Actuarial Liability is changed once a year at September 30. The unfunded liability for Military Retirement and Other Employment Related Actuarial Liabilities increased $112.3 billion. The variance is attributable to an increase of $140.1 billion in the actuarial liability that is offset by an increase of $27.8 billion in the value of assets available to pay benefits. The most significant increases were in military retirement pensions and military retirement health benefits, which increased $92.6 billion and $27.9 billion, respectively.

See note 17 for additional information about the change in actuarial estimates.

Total Liabilities Covered by Budgetary Resources

Total liabilities covered by Budgetary Resources increased $29.1 billion (10 percent). The Medicare-Eligible Retiree Health Care Fund's (MERHCF) investments increased $21.9 billion and the Military Retirement Fund increased $6.0 billion. This was a result of positive cash flow, resulting in an increase in assets available to pay benefits. As these assets become available, a corresponding portion of the actuarial liability is reclassified from Not Covered by Budgetary Resources to Covered by Budgetary Resources.

Note 12. Accounts Payable

As of March 31	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
1. Intragovernmental Payables	$ 1,929,348,839.47	$ N/A	$ 1,929,348,839.47	$ 738,463,775.84
2. Non-Federal Payables (to the Public)	27,473,642,895.90	2,629,211.12	27,476,272,107.02	25,173,679,251.82
3. Total	$ 29,402,991,735.37	$ 2,629,211.12	$ 29,405,620,946.49	$ 25,912,143,027.66

Total Accounts Payable increased $3.5 billion (13 percent).

Intragovernmental Accounts Payable

Intragovernmental Accounts Payable increased $1.2 billion (161 percent). The Judgment Fund Liability of $518 million was previously recorded as Other Liabilities. In 1st Quarter, FY 2005, The Judgment Fund Liability was reclassified to Accounts Payable. The balance of the increase results from the implementation of estimating methodologies allowed DoD agencies to record accounts payable with agencies outside DoD.

Nonfederal Payables

Nonfederal Accounts Payable increased $2.3 billion (9 percent).

Note 13. Debt

As of March 31	2005						2004	
		Beginning Balance		Net Borrowings		Ending Balance		Ending Balance
1. Agency Debt								
A. Debt to the Treasury	$	85,469,146.90	$	5,113,833.93	$	90,582,980.83	$	84,690,096.51
B. Debt to the Federal Financing Bank		506,277,717.36		(11,263,209.97)		495,014,507.39		606,373,244.36
C. Total Agency Debt	$	591,746,864.26	$	(6,149,376.04)	$	585,597,488.22	$	691,063,340.87
2. Total Debt	$	591,746,864.26	$	(6,149,376.04)	$	585,597,488.22	$	691,063,340.87

Debt to the Treasury

The outstanding debt consists of interest and principal payments due to the Treasury. The $5.9 million (7 percent) increase in Debt to the Treasury consists of a $6.7 million increase to a loan subsidy program related to the Family Housing Improvement Fund’s Military Housing Privatization Initiative (MHPI), which is offset by a $.8 million decrease to the U.S. Army Corps of Engineers promissory notes with the Treasury Fund Capital Improvements to the Washington Aqueduct.

The MHPI combines funds borrowed from the Treasury with appropriated funds (direct loan subsidy appropriation) to provide direct loans to private developers to build or renovate military family housing. An increase in MHPI of $6.7 million (9 percent) in Debt to the Treasury is primarily due to borrowing money from the Treasury to cover direct loans related to military family housing at two Army bases and five Air Force bases. The balance of Debt to the Treasury for MHPI is $75.6 million.

During FYs 1997, 1998, and 1999, the U.S. Army Corps of Engineers executed three promissory notes totaling $75.0 million with the Department of the Treasury. The funds provided by these notes were used for capital improvements to the Washington Aqueduct. The remaining balance of the three promissory notes is $15 million with repayment funds guaranteed by Arlington County; Falls Church, Virginia, and the District of Columbia.

Debt to the Federal Financing Bank

Debt owed to the Federal Financing Bank (FFB) decreased by $111.4 million (18 percent). This decrease is due to the reduction of the outstanding debt principal amount reported for Maritime Prepositioning Ships loans. As part of the Afloat Prepositioning Force program, the Navy makes loan repayments to the FFB on behalf of ship owners in lieu of capital lease payments to ship owners. Payments are made twice a year, in January and July. The FFB is reporting debt in the amount of $495 million for the Transportation Activity, which represents an outstanding principal balance of $487.6 million and accrued interest payable of $7.4 million.

Note 14. Environmental Liabilities and Disposal Liabilities

As of March 31	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
1. Environmental Liabilities – Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations – Environmental Restoration (ER)	$ 1,462,414,775.63	$ 8,876,446,447.58	$ 10,338,861,223.21	$ 10,973,567,043.88
2. Active Installations – ER for Closed Ranges	57,009,000.00	7,319,805,000.00	7,376,814,000.00	4,442,883,100.00
3. Formerly Used Defense Sites (FUDS) -- ER	255,740,000.00	3,977,640,000.00	4,233,380,000.00	4,191,222,000.00
4. FUDS--ER for Transferred Ranges	114,578,000.00	13,810,031,000.00	13,924,609,000.00	13,634,362,000.00
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations – Environmental Corrective Action	51,509,016.80	502,849,236.17	554,358,252.97	548,410,995.80
2. Active Installations – Environmental Closure Requirements	15,999,000.00	162,499,000.00	178,498,000.00	103,528,200.00
3. Active Installations – Environ. Response at Active Ranges	62,500,000.00	217,132,000.00	279,632,000.00	276,368,000.00
4. Other	60,287.00	8,900,920.00	8,961,207.00	43,055,689.00
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations-- Environmental Restoration (ER)	363,681,000.00	2,580,916,001.73	2,944,597,001.73	3,466,940,522.44
2. BRAC Installations--ER for Transferring Ranges	9,242,000.00	531,272,000.00	540,514,000.00	553,925,000.00
3. BRAC Installations-- Environmental Corrective Action	9,175,606.94	149,556,436.43	158,732,043.37	181,835,496.00
4. Other	0.00	172,690,000.00	172,690,000.00	218,525,000.00
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0.00	6,426,100,000.00	6,426,100,000.00	5,693,000,000.00
2. Nuclear Powered Submarines	0.00	5,765,600,000.00	5,765,600,000.00	5,172,400,000.00
3. Other Nuclear Powered Ships	0.00	223,900,000.00	223,900,000.00	287,500,000.00
4. Other National Defense Weapons Systems	3,641,500.00	256,064,242.25	259,705,742.25	292,189,628.25
5. Chemical Weapons Disposal Program	527,959,000.00	9,703,897,000.00	10,231,856,000.00	11,388,939,000.00
6. Other	88,047,654.00	0.00	88,047,654.00	103,085,000.00
2. Total Environmental Liabilities:	$ 3,021,556,840.37	$ 60,685,299,284.16	$ 63,706,856,124.53	$ 61,571,736,675.37

Defense Wide

Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities (Amounts in millions)	Army	Navy	Air Force	ODO	Total
1. Environmental Liabilities-Nonfederal					
A. Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs:					
1. Active Installations-Environmental Restoration (ER)	$ 3,347.2	$ 2,715.0	$ 4,040.0	$ 236.6	10,338.8
2. Active Installations--ER for Closed Ranges	5,496.5	535.4	1,344.9		7,376.8
3. Formerly Used Defense Sites (FUDS) – ER	4,233.3				4,233.3
4. FUDS--ER for Transferred Ranges	13,924.6				13,924.6
B. Other Accrued Environmental Costs (Non-DERP funds)					
1. Active Installations--Environmental Corrective Action	259.0		176.0	119.3	554.3
2. Active Installations--Environmental Closure Requirements	51.2		112.3	15.0	178.5
3. Active Installations--Environ. Response at Active Ranges	267.6			12.0	279.6
4. Other				9.0	9.0
C. Base Realignment and Closure (BRAC)					
1. BRAC Installations--Environmental Restoration (ER)	597.3	1037.2	1,292.4	17.7	2,944.6
2. BRAC Installations--ER for Transferring Ranges	480.1	60.4			540.5
3. BRAC Installations--Environmental Corrective Action	25.0		133.8		158.8
4. Other	172.7				172.7
D. Environmental Disposal for Weapon Systems Programs					
1. Nuclear Powered Aircraft Carriers		6,426.1			6,426.1
2. Nuclear Powered Submarines		5,765.6			5,765.6
3. Other Nuclear Powered Ships		223.9			223.9
4. Other National Defense Weapon Systems		259.7			259.7
5. Chemical Weapons Disposal Program	10,231.9				10,231.9
6. Other				88.0	88.0
2. Total Nonfederal Environmental Liabilities:	39,086.4	17,023.3	7099.4	497.6	**63,706.7**

Other Information

Others Category Disclosure Comparative Table

Types	March 31, 2005 *($ in Millions)*
Other Accrued Environmental Costs (Non-DERP funds)	
DoD Component Level Accounts	$ 0.2
Defense Commissary Agency	$ 8.8
Total	**$ 9.0**
Base Realignment and Closure	
Army's Prior BRAC Unliquidated Obligations that cannot be identified to a specific program	**$ 172.7**
Environmental Disposal for Weapons Systems Programs -Other	
National Defense Stockpile –Other Defense Organizations (ODO)	**$ 88.0**

Defense Wide

The Department of Defense (DoD) is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other past activity, which have created a public health or environmental risk. The Department accomplishes this effort in coordination with regulatory agencies, and if applicable, with other responsible parties and current property owners. The Department is also required to recognize closure and post-closure costs for its General Property, Plant, and Equipment (PP&E) and environmental corrective action costs for current operations. Each of the Department's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapons systems, and environmental costs related to the Base Realignment and Closures (BRAC) actions that have taken place in prior years.

The Department uses engineering estimates and independently validated models to estimate environmental liabilities. The models are contained within the Remedial Action Cost Engineering Requirements (RACER) and the Department of the Navy Normalization of Data System (NORM). The Department validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

The DoD has clean up requirements for the DERP sites at active and BRAC installations and Formerly Used Defense Sites (FUDS), non-DERP at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination clean up is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, current property owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates can put DoD at risk of incurring fines and penalties.

The clean up requirements for nuclear-powered aircraft carriers, submarines, and other nuclear ships are based on the significant laws which affect the Department's conduct of environmental policy and regulations. The Atomic Energy Act of 1954, as amended, assures the proper management of source, special nuclear, and byproduct material. As in all cases with nuclear power, the Department coordinates actions with the Department of Energy. The Nuclear Waste Policy Act of 1982 requires all owners and generators of high-level nuclear waste and spent nuclear fuel to pay their respective shares of the full cost of the program. Finally, the Low Level Radioactive Waste Policy Amendments Act of 1986 provides for the safe and efficient management of low-level radioactive waste.

The Chemical Weapons Disposal Program is based on the FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention (CWC) treaty. The United States ratified the treaty in April 1997 that required the stockpile of chemical weapons to be destroyed by April 2007, according to the terms outlined. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

The estimated total clean up cost for the current operating period is assigned based on the amount of the current year appropriation and unliquidated obligations that will be expended within 12 months from the Balance Sheet date. The noncurrent clean up cost is the portion of the clean up cost that will be expended more than 12 months from the Balance Sheet date.

The DoD has not identified any unrecognized portion of the estimated total clean up cost associated with General Property, Plant and Equipment (PP&E). The Department requires the unamortized clean up cost associated with PP&E to be recognized and is working with the Military Departments to ensure this policy is properly implemented.

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, better site characterization with sampling, and restimation based on different assumptions, lessons learned, and advances in technology. Environmental liabilities can also change in the future due to changes in laws and regulations, and changes in agreements with regulatory agencies.

Defense Wide

The Active Installations – ER for Closed Ranges increased by $2.9 billion (66 percent). The Army reported an increase of $2.4 billion due to the completion of estimating additional sites identified in their universe. The Navy reported an increase of $67.9 million due to additional costs identified during the performance of site investigations. The Air Force also reported an increase of $506.7 million that resulted from the identification of 30 additional sites.

Active Installations-Environmental Closure Requirements increased $75.0 million (72 percent). The Air Force reported an increase of $45.9 million that is attributable to the identification of additional landfill sites and a change in the amortization calculation that is now systematically recognizing the liability estimates over the life of an asset rather than assessing the liability in the year of disposal. The Army increased $14.1 million that is attributable to the receipt of an updated Environmental Program Requirements (EPR) report with improved cost estimates and site changes, as well as the addition of previously omitted Class Zero projects. The remaining increase of $15.0 million is due to a reclassification from Environmental Disposal for Weapons Systems Programs -Other to Active Installations-Environmental Closure Requirements.

Other Accrued Environmental Costs (Non-DERP funds) – Other decreased $34.1 million (79 percent). The decrease is primarily attributable to adjustments made within the DoD Component Level Account.

The BRAC Installations – Environmental Restoration (ER) decreased $522.3 million (15 percent). The net decrease is primarily due to a $78.6 million increase reported by the Army, a $532.7 million decrease reported by the Air Force, and a $12.6 million decrease reported by the Defense Logistics Agency. The increase reported by the Army is due to the increased remediation efforts required. The decrease reported by the Air Force resulted from implementation of a new cost estimating and reporting policy that limits the liability to 25 years of remediation action operations along with five years of long term monitoring. The remaining decrease reported by the Defense Logistics Agency is primarily due to new engineering cost estimates.

The BRAC Installations-Environmental Corrective Action decreased $23.0 million (13 percent). The variance is primarily due to a decrease in Army cost estimates that reflect changes in required cleanup actions at a site.

Base Realignment and Closure (BRAC) – Other decreased $45.8 million (21 percent). The decrease is attributable to disbursements for completed or partial completion of environmental projects.

Nuclear Powered Aircraft Carriers increased $733.1 million (13 percent) and Nuclear Powered Submarines increased $593.2 million (11 percent). The Navy Working Capital Fund (NWCF) manages the disposal of these assets. The increases are attributed to a 13 percent NWCF price increase for FY 2005.

Other Nuclear Powered Ships decreased $63.6 million (22 percent). The decrease is attributable to adjustments made in the liability estimates and overall execution of the ship disposal program.

Other National Defense Weapons Systems decreased $32.5 million (11 percent). The decrease is primarily attributable to a decrease in the Air Force. The Air Force previously reported a liability for disposal of conventional munitions; however, the Army is the Department's executive agent for the conventional weapons disposal. The Army reports this liability on their financial statements.

Chemical Weapons Disposal Program decreased $1.2 billion (10 percent). The decrease is due to the Army destroying chemical agents and munitions and disbursing funds for the completed work.

Environmental Disposal for Weapons Systems Programs – Other decreased $15.1 million (15 percent). The variance is primarily due to a reclassification from Environmental Disposal for Weapons Systems Programs -Other to Active Installations-Environmental Closure Requirements within the DoD Component Level Accounts.

Note 15. Other Liabilities

As of March 31	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
1. Intragovernmental				
A. Advances from Others	$ 644,505,158.69	$ 0.00	$ 644,505,158.69	$ 874,644,839.25
B. Deposit Funds and Suspense Account Liabilities	443,879,699.99	0.00	443,879,699.99	877,012,514.58
C. Disbursing Officer Cash	2,165,342,019.83	0.00	2,165,342,019.83	1,390,109,304.42
D. Judgment Fund Liabilities	154,365,563.80	0.00	154,365,563.80	518,428,480.79
E. FECA Reimbursement to the Department of Labor	726,706,399.46	529,264,252.15	1,255,970,651.61	1,131,834,144.63
F. Other Liabilities	4,334,548,647.79	1,637,141,206.62	5,971,689,854.41	5,894,184,146.74
G. Total Intragovernmental Other Liabilities	$ 8,469,347,489.56	$ 2,166,405,458.77	$ 10,635,752,948.33	$ 10,686,213,430.41
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 8,901,946,733.10	$ 1,290,604,909.00	$ 10,192,551,642.10	$ 8,258,686,847.55
B. Advances from Others	1,685,671,456.62	0.00	1,685,671,456.62	1,362,247,216.14
C. Deferred Credits	7,717,399.35	0.00	7,717,399.35	5,891,960.57
D. Deposit Funds and Suspense Accounts	617,738,027.90	0.00	617,738,027.90	351,775,355.41
E. Temporary Early Retirement Authority	508,530.53	263,000.00	771,530.53	2,643,504.20
F. Nonenvironmental Disposal Liabilities				
(1) National Defense PP&E (Nonnuclear)	0.00	590,418,056.81	590,418,056.81	576,686,000.81
(2) Excess/Obsolete Structures	53,581,000.00	235,897,000.00	289,478,000.00	722,537,500.00
(3) Conventional Munitions Disposal	0.00	1,334,017,104.54	1,334,017,104.54	1,191,218,052.00
(4) Other	49,111.68	0.00	49,111.68	(99,000.00)
G. Accrued Unfunded Annual Leave	8,238,170,823.79	0.00	8,238,170,823.79	7,810,360,576.46
H. Capital Lease Liability	53,490,982.23	221,434,752.52	274,925,734.75	329,327,560.67
I. Other Liabilities	7,052,748,000.28	1,559,442,112.87	8,612,190,113.15	8,918,954,962.91
J. Total Nonfederal Other Liabilities	$ 26,611,622,065.48	$ 5,232,076,935.74	$ 31,843,699,001.22	$ 29,530,230,536.72
3. Total Other Liabilities	$ 35,080,969,555.04	$ 7,398,482,394.51	$ 42,479,451,949.55	$ 40,216,443,967.13

Line 1F, Intragovernmental Other Liabilities, consists of custodial liabilities and employee benefits.

Line 2I, Nonfederal Other Liabilities, consists of custodial liabilities, contingent liabilities, and accrued work performed by contractors that has not yet been billed.

Capital Lease Liability

As of March 31	2005				2004
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due					
A. 2005	$ 76,304,923.85	$ 105,847.20	$ 0.00	$ 76,410,771.05	$ 76,913,079.70
B. 2006	60,041,331.79	1,000,000.00	0.00	61,041,331.79	66,259,692.32
C. 2007	47,482,178.53	3,879,000.00	0.00	51,361,178.53	63,160,637.19
D. 2008	43,853,305.76	0.00	0.00	43,853,305.76	50,584,885.57
E. 2009	43,853,305.76	0.00	0.00	43,853,305.76	44,353,046.76
F. After 5 Years	85,394,190.08	0.00	0.00	85,394,190.08	179,195,510.54
G. Total Future Lease Payments Due	$ 356,929,235.77	$ 4,984,847.20	$ 0.00	$ 361,914,082.97	$ 480,466,852.08
H. Less: Imputed Interest Executory Costs	87,259,889.32	274,583.90	0.00	87,534,473.22	151,139,291.03
I. Net Capital Lease Liability	$ 269,669,346.45	$ 4,710,263.30	$ 0.00	$ 274,379,609.75	$ 329,327,561.05
2. Capital Lease Liabilities Covered by Budgetary Resources				$ 201,133,860.24	$ 326,108,304.45
3. Capital Lease Liabilities Not Covered by Budgetary Resources				$ 73,791,874.51	$ 121,606,591.22

For the Department of Defense, all leases prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Noncurrent amounts for these leases are shown as not covered by budgetary resources.

Leases originating after FY 1992 are required to be fully funded in the year of their inception. Therefore, budgetary resources show the present value of those lease payments as covered by budgetary resources.

Note 16. Commitments and Contingencies

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from the Department's resources, either directly or by reimbursement to the Judgment Fund. Based on information currently available, however, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the Department.

The Department is aggressively contesting the claimed liability of the Government in each of the litigation, claims or assessments. Except as indicated below, the Department is unable to predict the likely outcome or the amount of liability because most of the litigation, claims, or assessments are in the preliminary stage. As of September 30, 2004, the Department reported one case with a probable loss to the Government. The status of this case remains the same for the 2nd Quarter, FY 2005. It is likely that the United States will have to pay some amount of damages. It is impossible to predict the outcome of the litigation on the question of damages with any degree of certainty; therefore, the ultimate liability of the Government cannot be reasonably estimated at this time.

In August 1998, a contractor filed with the Armed Services Board of Contract Appeals (ASBCA) an appeal of the Contracting Officer's denial of its agency-level claim. The contractor is seeking a total of $279 million ($164 million damages for "value of service" and $115 million damages for "loss of revenues") for government noncompliance on the license agreement during November 1994 through September 1997. A hearing on entitlement was held before the ASBCA in May 2000. The ASBCA issued its decision in March 2001, finding that the Government had breached the terms of the license agreement. The burden is now on the contractor to prove its claimed damages. A hearing on damages has not been scheduled nor has the Defense Contract Audit Agency audited the contractor's claim.

Other Commitments and Contingencies

In addition, the Department has other possible contingent liabilities primarily consisting of the Chemical Demilitarization Non-Stockpile Disposal of $9.2 billion (the estimated cost of destroying buried chemical munitions). These liabilities are not accrued in the Department's financial statements because the likelihood of expenditure of resources is not probable.

Note 17. Military Retirement Benefits and Other Employment Related Actuarial Liabilities

As of March 31	2005				2004
	Actuarial Present Value of Projected Plan Benefits	Assume Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
1. Pension and Health Benefits					
A. Military Retirement Pensions	$ 834,582,098,074.36	6.25	$ (210,360,153,366.23)	$ 624,221,944,708.13	$ 531,586,767,750.10
B. Military Retirement Health Benefits	221,242,011,000.00	6.25	0.00	221,242,011,000.00	206,839,265,000.00
C. Medicare-Eligible Retiree Benefits	504,073,807,000.00	6.25	(62,088,805,774.84)	441,985,001,225.16	436,012,177,417.62
D. Total Pension and Health Benefits	$ 1,559,897,916,074.40		$ (272,448,959,141.07)	$ 1,287,448,956,933.30	$ 1,174,438,210,167.70
2. Other					
A. FECA	$ 6,958,975,057.86		$ 0.00	$ 6,958,975,057.86	$ 7,596,102,000.03
B. Voluntary Separation Incentive Programs	1,593,549,446.00	4.0	(804,688,141.73)	788,861,304.27	830,918,308.10
C. DoD Education Benefits Fund	1,254,490,736.00	5.3	(1,211,157,621.95)	43,333,114.05	35,168,773.48
D. Total Other	$ 9,807,015,239.86		$ (2,015,845,763.68)	$ 7,791,169,476.18	$ 8,462,189,081.61
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,569,704,931,314.30		$ (274,464,804,904.75)	$ 1,295,240,126,409.50	$ 1,182,900,399,249.30

Fluctuations

The unfunded liability for Military Retirement and Other Employment Related Actuarial Liabilities increased $112.3 billion (10 percent). The variance is attributable to an increase of $140.1 billion in the actuarial liability that is offset by an increase of $27.8 billion in the value of assets available to pay benefits.

The unfunded actuarial liability for the Military Retirement Pensions increased $92.6 billion (17 percent). The variance is attributable to an increase of $98.5 billion in the overall liability for the Military Retirement Fund (MRF) that is offset by an increase of $5.9 billion in the value of assets available to pay benefits. Additional information is contained in the Military Retirement paragraph.
The unfunded actuarial liability for the DoD Education Benefits Fund increased $8.1 million. The increase is the result of an increase in the actuarial liability of $46.3 million that is offset by the increase of $38.2 million in the value of the assets available to pay benefits. Additional information is discussed in the DoD Education Benefits Fund paragraph.

Military Retirement

The increase in the actuarial liability is primarily the result of an amendment to the MRF Plan established by the National Defense Authorization Act for FY 2004 for new concurrent receipt benefits.

The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund, authorized by PL 98-94, come from three sources: Interest earnings on

Fund assets, monthly DoD contributions, and annual contributions from the Treasury Department. The monthly DoD contributions are determined as a percentage (approved by the DoD Retirement Board of Actuaries) of basic pay. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. Effective FY 2005, Treasury began making annual contribution to the Fund that represents the normal cost amount for the new concurrent receipt provisions of the 2004 National Defense Authorization Act. The Board determines Treasury's contribution and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The long-term economic assumptions for each valuation are set by the DoD Retirement Board of Actuaries. The long-term assumptions for the FY 2003 valuation were 6.25 percent interest, 3.0 percent Consumer Price Index, and 3.75 percent salary increase. The long-term economic assumptions did not change for the FY 2004 valuation. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Because of reporting deadlines, the FY 2004 actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year valuation results as reported in the DoD office of Actuary Valuation of the Military Retirement System. In calculating the FY 2004 roll-forward amount, the following assumptions were used:

	Inflation	Salary	Interest
Fiscal Year 2004	2.1 percent (actual)	3.7 percent (actual)	6.25 percent
Fiscal Year 2005	2.4 percent (estimated)	3.5 percent (estimated)	6.25 percent
Long-Term	3.0 percent	3.75 percent	6.25 percent

For purposes of the Fund's financial reporting, this roll-forward process is applied annually.

Actuarial Cost Method Used: Aggregate entry-age normal method.

Market Value of Investments in Market-Based and Marketable Securities: $210.3 billion

	(Amounts in Millions) FY 04
Actuarial Liability as of 9/30/03	$736,061.6
Expected Normal Cost for FY 04	12,857.2
Plan Amendment Liability	81,062.7
Assumption Change Liability	(32.5)
Expected Benefit Payments for FY 04	(36,623.5)
Interest Cost for FY 04	45,272.4
Actuarial (gains)/losses due to changes in trend assumptions	(4,015.8)
Actuarial Liability as of 09/30/04	$834,582.1
Change in Actuarial Liability	$98,520.5

Military Retirement Health Benefits (MRHB)

The unfunded actuarial liability for the Military Retirement Health Benefits increased $14.4 billion. The increase is attributable to an increase in the overall actuarial liability.

Defense Wide

Change in Defense Health Program MRHB Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/03 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect)	$206,839.4
Expected Normal Cost for FY04	7,421.8
Expected Benefit Payments for FY04	(6,939.3)
Interest Cost for FY04	12,942.3
Actuarial (gains)/losses due to other factors	11,564.9
Actuarial (gains)/losses due to changes in trend assumptions	(10,587.1)
Actuarial Liability as of 09/30/04 (DoD pre-Medicare + all uniformed services Medicare cost-basis effect)	$221,242.0
Change in Actuarial Liability	$14,402.6

Assumptions in Calculation of DHP Liability:
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	5.1% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Outpatient:	6.8% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Direct Care):	9.7% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Purchased Care):	14.6% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Inpatient:	5.9% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Outpatient:	8.4% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Non-Medicare Prescriptions:	11.3% from FY03 to FY04, ultimate rate of 6.25% in 2028.

Other Information

The “DHP” liability includes pre-Medicare liabilities for the Department of Defense, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2004 liability was:

	(Amounts in millions)
DoD	$220,865.0
Coast Guard	334.0
Public Health Service	40.0
NOAA	3.0
Total	$221,242.0

Liabilities for direct care in the Military Retirement Health Benefits are valued at a higher cost basis as established by the Government Accountability Office (GAO). As a result, the Medicare portion of the Military Retirement Health Benefits liability is approximately $16.9 billion higher than the corresponding liability for the MERHCF. This $16.9 billion amount is included in the DHP liability.

Actuarial gains/losses due to other factors include new population data, other actuarial experience being different from assumed, and actuarial assumption changes other than the change in trend assumptions.

Actuarial Cost Method Used for DHP Actuarial Liability: Aggregate Entry-Age Normal

Medicare-Eligible Retiree Benefits

The unfunded actuarial liability increased $6.0 billion. The increase is attributable to an increase of $27.9 billion in the actuarial liability that is substantially offset by the increase of $21.9 billion in the value of assets available to pay benefits.

Changes in MERHCF Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/03 (all uniformed services Medicare)	$476,170.3
Expected Normal Cost for FY04	10,187.8
Expected Benefit Payments for FY04	(5,911.8)
Interest Cost for FY04	29,892.2
Actuarial (gains)/losses due to other factors	(1,430.6)
Actuarial (gains)/losses due to changes in trend assumptions	(4,834.1)
Actuarial Liability as of 09/30/04 (all uniformed services Medicare)	$504,073.8
Change in Actuarial Liability	$27,903.5

Assumptions in Calculation of MERHCF Liability
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	5.1% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Outpatient:	6.8% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Direct Care):	9.7% from FY03 to FY04, ultimate rate of 6.25% in 2028.
Medicare Prescriptions (Purchased Care):	14.6% from FY03 to FY04, ultimate rate of 6.25% in 2028.

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2004, liability was:

	(Amounts in millions)
DoD	$493,717.0
Coast Guard	9,263.7
Public Health Service	1,024.9
NOAA	68.2
Total	$ 504,073.8

FY 2003 Service contributions to the MERHCF were:

	(Amounts in millions)
DoD	$7,918.8
Coast Guard	192.3
Public Health Service	27.4
NOAA	1.2
Total	$ 8,139.7

Assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Claims cost assumptions for direct care were based on actual experience; assumptions for purchased care were developed from industry-based cost estimates adjusted to approximate the military retired population.

Projected revenues into the Medicare Eligible Retiree Health Care Fund, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, monthly Uniformed Services contributions, and annual contributions from the Treasury Department. The monthly contributions are determined as a per-capita amount (approved by the DoD Medicare Eligible Retiree Health Care Board of Actuaries) times end strength. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have arisen since then. The Board determines Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

The actuarial liability reported above does not include $838.3 million in incurred but not reported liabilities. These liabilities are disclosed in the Liabilities Not Covered and Covered by Budgetary Resources note, and the Other Liabilities note.

Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year's results. For purposes of the Fund's financial reporting, this process is applied annually.

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal

Market Value of Investments in Market-Based and Marketable Securities: $238.7 billion

Federal Employees Compensation Act (FECA)

The unfunded liability for FECA decreased 8 percent.

Assumptions

The actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DoD at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined by using historical benefit payment patterns to predict the future payments. Cost-of-living adjustments and medical inflation factors are also included in the calculation of projected future benefits. Consistent with past practices, these projected annual benefit payments are then discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Year 1	3.84%
Year 2	4.35%
Year 3 and thereafter	4.35%

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost-of-living adjustments or COLAs) and medical inflation factors (consumer price index-medical, or CPIMs) were applied to the calculation of projected future benefits. These factors were also used in adjusting the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPIM
2004	2.30%	3.21%
2005	2.00%	3.54%
2006	1.83%	3.64%
2007	1.97%	3.80%
2008+	2.17%	3.92%

The model's resulting projections were critically analyzed to insure that the estimates were reliable. The analysis was primarily based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year, as calculated for the current projection to the liability-payment ratio calculated for the prior projection.

Voluntary Separation Incentive Programs (VSI)

The unfunded actuarial liability decreased $42.0 million. The decrease is the net result of a decrease of $96.4 million in the actuarial liability, and a decrease of $54.4 million in the value of assets available to pay benefits.

The VSI program was established by Public Law 102-190. The intent of this program is to reduce the number of military personnel on active duty. This plan was offered to personnel with a minimum of six years of service who do not qualify for retirement. The incentive payments are spread over a period equivalent to twice the years of active service.

The annual payment is based on 2.5 percent of the person's basic pay at the time they leave service multiplied by the number of years of service. The September 30, 2004, VSI Actuarial Present Value of Projected Plan Benefits (Actuarial Liability) was calculated at an assumed annual interest rate of 4 percent.

Since the VSI program is discontinued for new takers, each year the Actuarial Liability is expected to decrease with benefit outlays, and increase with interest cost. In the absence of (1) actuarial gains and losses, and (2) assumption changes, a decrease of $91.2 million in the Actuarial Liability was expected during FY 2004. The September 30, 2004, Actuarial Liability includes changes due to experience, which resulted in a net gain of $5.3 million. This reflects the new population on which the September 30, 2004, Actuarial Liability is based, as well as other economic experience being different than assumed.

The Present Value of Projected Plan Benefits (Actuarial Liability) for the VSI Fund, as of September 30, 2004, is $1.6 billion. It has been calculated as in prior years; namely, as the present value, as of September 30, 2004, of all remaining VSI payments.

Market Value of Investments in Market-based and Marketable Securities: $753.3 million.

DoD Education Benefits Fund

The increase in the DoD Education Benefits unfunded actuarial liability is the combined result of an increase of $46.3 million in the actuarial present value of the plan benefits, and an increase of $38.2 million in the value of the assets available to pay benefits. The modified estimate of the present value of benefits (PVB) for the DoD Education includes more complete experience. The increase in the actuarial liability is the result of an increase of $64 million due to an additional year of new entrants and calculating the present value of the stream of projected future benefits as of a year later, and a PVB decrease of $18 million related to a higher interest rate assumption (5.3 percent versus 4.4 percent).

The Education Benefits Fund was established by Public Law 98-525. The program is designed to accumulate funds for the Educational Assistance program to promote the recruitment and retention of members for the All-Volunteer Forces program and the Total Force Concept of the Armed Forces and aid in the readjustment of members of the Armed Forces to civilian life after separation from military service.

Market Value of Investments in Market-based and Marketable Securities: $1.0 billion.

Note 18. Disclosures Related to the Statement of Net Cost

General Disclosures Related to the Statement of Net Cost

This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

For General Funds, the amounts presented in the Statement of Net Cost (SoNC) are based on obligations and disbursements and therefore may not, in all cases, accrue actual costs. While the Department's Working Capital Fund (WCF) generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner. As such, information presented in the SoNC is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems, adjusted to record known accruals for major items such as payroll expenses, accounts payable, and, environmental liabilities.

Fluctuations

Intragovernmental Gross Costs increased $4.8 billion (79 percent)

This increase is primarily attributed to improved business processes to recognize intragovernmental costs, previously classified as costs with the public. In addition, a portion of the variance is related to increased expenditures in FY 2005 required to support contingency operations, antiterrorism base operations, and force protection requirements.

Intragovernmental Earned Revenue increased $1.9 billion (29 percent)

The Military Retirement Fund increased $271.4 million. This increase resulted from the increase in the Annual Treasury Payments and an increase in interest on investments.

The Medicare Eligible Retiree Health Care Fund (MERCHF) increased $548.2 million. This resulted primarily from increases in contributions from the US Public Health Service, the US Coast Guard, and the National Oceanic Atmospheric Administration, and interest on investments. These increases were offset by a decrease in the US Treasury Annual Unfunded Liability Payment.

USACE had an increase of $679.9 million. This increase is primarily attributable to funding received from FEMA to perform numerous missions to support those affected by the four hurricanes that struck Florida in the fall of 2004.

The Army General Fund increased $124.6 million. This increase is attributable to increased funding in support of contingency missions for security services and munitions, and research and development projects, and other logistics and personal related support.

The Air Force General Fund reported an increase of $98.2 million, which was the result of improved business processes to better identify Intragovernmental Revenue.

Earned Revenue from the Public increased $2.1 billion (18 percent)

The DLA increase of $1.4 billion is primarily the result of recognizing a gain due to a change in accounting procedures. The DLA is converting fuel inventory from Adjusted Latest Acquisition Cost to the First-In, First-Out inventory valuation method.

The Army had a net decrease in the amount of $2.1 billion. This decrease is primarily the result of inventory transactions performed by their new system LMP. LMP overstated gains and loses.

Defense Wide

The Navy had a net increase of $1.4 billion. The increase resulted in part from increased activity with DON's public customers and in part to adjustments to cover Intragovernmental revenues in the Trading Partner process.

The Air Force increase of $1.2 billion primarily is attributable to other gains reported for assets that were not previously recorded in property records.

Defense Health Program had an increase of $279 million. This is primarily attributable to better business processes that better identified Revenue from Public.

Gross Cost and Earned Revenue by Budget Functional Classification

As of March 31	2005			2004
	Gross Cost	(Less: Earned Revenue)	Net Cost	Net Cost
Budget Functional Classification				
1. Department of Defense Military (051)	$ 220,394,205,525.17	$ (14,936,536,027.32)	$ 205,457,669,497.85	$ 200,155,360,720.34
2. Water Resources by U.S. Army Corps of Engineers (301)	4,849,436,658.43	(1,118,572,295.02)	3,730,864,363.41	2,129,907,737.94
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	51,689,371.31	0.00	51,689,371.31	57,249,445.58
4. Federal Employees Retirement and Disability, Department of Defense Military Retirement Fund (602)	19,103,783,361.09	(5,078,488,312.77)	14,025,295,048.32	13,328,288,088.17
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	164,984,770.55	(16,982,879.41)	148,001,891.14	140,012,411.52
6. Medicare Eligible Retiree Health Care Fund (551)	2,659,796,637.02	(953,653,231.62)	1,706,143,405.40	(1,138,539,157.11)
7. Total	$ 247,223,896,323.57	$ (22,104,232,746.14)	$ 225,119,663,577.43	$ 214,672,279,246.44

Gross Cost to Generate Intragovernmental Revenue and Earned Revenue (Transactions with Other Federal—Non-DoD—Entities) by Budget Functional Classification

As of March 31	2005			2004
	Gross Cost to Generate Intragovernmental Revenue	(Less: Earned Revenue)	Net Cost	Net Cost
1. Department of Defense Military (051)	$ 10,288,638,018.58	$ (1,419,072,354.95)	$ 8,869,565,663.63	$ 4,479,480,561.48
2. Water Resources by U.S. Army Corps of Engineers (301)	423,143,552.80	(948,935,891.08)	(525,792,338.28)	150,243,229.87
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	950,416.06	0.00	950,416.06	543,434.51
4. Federal Employees Retirement and Disability Department of Defense Military Retirement Trust Fund (602)	0.00	(5,078,488,312.77)	(5,078,488,312.77)	(4,807,132,037.53)
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	164,935,384.29	(16,933,493.15)	148,001,891.14	140,012,411.52
6. Medicare Eligible Retiree Health Care Fund (551)	0.00	(953,653,231.62)	(953,653,231.62)	(405,501,122.18)
7. Total	$ 10,877,667,371.73	$ (8,417,083,283.57)	$ 2,460,584,088.16	$ (442,353,522.33)

Benefit Program Expenses

As of March 31	2005		2004	
1. Service Cost	$	0.00	$	0.00
2. Period Interest on the Benefit Liability		0.00		0.00
3. Prior (or past) Service Cost		0.00		0.00
4. Period Actuarial Gains or (Losses)		0.00		0.00
5. Gains/Losses Due to Changes in Medical Inflation Rate Assumption		0.00		0.00
6. Total Benefit Program Expense	$	0.00	$	0.00

Amounts for Foreign Military Sales (FMS) Program Procurements from Contractors

Revenue and expense amounts pertaining to FMS items provided by DoD contractors are not reported in the Statement of Net Cost. However, we estimate the amount of such revenue and expense to be $4.2 billion (81% of $5.2 billion CFY Trust Funds Disbursed). A Statement of Custodial Activity is provided which reports the amounts of cash collections and disbursements of the FMS Trust Fund through the 2nd Quarter, FY 2005.

Stewardship Assets

Stewardship assets include Heritage Assets, Stewardship Land, Non-Federal Physical Property, and Investments in Research and Development. The current-year cost of acquiring, constructing, improving, reconstructing or renovating stewardship assets are included in the SoNC. Material yearly investment amounts related to stewardship assets are provided in the Required Supplemental Stewardship Information section of the mid-year and annual financial statements.

Suborganization Program Costs

The Department of Defense (DoD) is in the process of reviewing available data and attempting to develop a cost reporting methodology that fulfills the need for cost information required by SSFAS No 4. Until cost-allocating processes and expanded intra-DoD eliminating capabilities are incorporated into the accounting processes, the usefulness of further sub-organization reported (major command) net costs is limited. Therefore, no additional statements of sub-organization cost at lower levels are presented with these statements.

Note 19. Disclosures Related to the Statement of Changes in Net Position

As of March 31	2005 Cumulative Results of Operations	2005 Unexpended Appropriations	2004 Cumulative Results of Operations	2004 Unexpended Appropriations
1. Prior Period Adjustments Increases (Decreases) to Net Position				
A. Changes in Accounting Standards	$ 0.00	$ 0.00	$ 0.00	$ 0.00
B. Errors and Omissions in Prior Year Accounting Reports	0.00	0.00	(14,309,208,905.32)	25,913,749,160.94
C. Other Prior Period Adjustments	0.00	0.00	0.00	0.00
D. Total Prior Period Adjustments	$ 0.00	$ 0.00	$ (14,309,208,905.32)	$ 25,913,749,160.94
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 753,527,017.20	$ 0.00	$ 819,471,229.81	$ 0.00
B. Civilian Health	1,217,172,016.19	0.00	1,096,076,702.50	0.00
C. Civilian Life Insurance	12,291,573.92	0.00	7,027,638.60	0.00
D. Judgment Fund	165,152,446.28	0.00	72,293,076.02	0.00
E. Total Imputed Financing	$ 2,148,143,053.59	$ 0.00	$ 1,994,868,646.93	$ 0.00

Imputed Financing

The amounts the Department of Defense remits to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System (CSRS), the Federal Employees' Retirement System (FERS), the Federal Employees' Health Benefits (FEHB) program, and the Federal Employees' Group Life Insurance (FEGLI) program do not fully cover the government's cost to provide these benefits. An imputed cost is recognized as the difference between the government's cost of providing these benefits to employees and the Agency’s contributions for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for the computation of imputed financing costs. These costs are provided by DFAS to the Office of the Under Secretary of Defense (Personnel and Readiness) for validation and approval. The approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Fluctuations

Cumulative Results of Operations

Other Adjustments (Line 4.C) decreased $5.4 billion due to the correct reporting of funds transferred to the Army from the Executive Office of the President for the Army Iraqi Relief and Reconstruction Fund. These transfers are correctly reported as Budgetary Financing Sources, Transfers-in/out Without Reimbursement (Line 4.G). In FY 2004, these transfers were reported as Other Financing Sources.

Budgetary Financing Sources, Nonexchange Revenue (Line 4.E.) increased $494.4 million. The increase is primarily due to the collection of taxes and interest for the Harbor Maintenance Trust Fund and Inland Waterways Trust Fund.

Donations and forfeitures of cash and cash equivalents (Line 4.F) increased by $21.9 million. The increase is attributable to donations made to the Navy and Other Defense Organizations.

Budgetary Financing Sources, Transfers-in/out Without Reimbursement (Line 4.G.) increased $2.6 billion primarily due to the transfer-in of funds from the Executive Office of the President for the Iraqi Relief and Reconstruction Fund.

Budgetary Financing Sources, Other Budgetary Financing Sources (Line 4.H.) decreased $15.8 billion. The decrease is primarily due to adjustments to bring the proprietary accounts into agreement with the budgetary accounts. Due to system deficiencies, there are unreconciled differences between the budgetary and proprietary trial balances. The net of these adjustments are reflected in Other Budgetary Financing Sources on the Statement of Net Position.

Other Financing Sources, Transfers-in/out Without Reimbursement (Line 5.B.) decreased by $2.8 billion. The variance is attributable to a transfer in of an actuarial liability from the U.S. Coast Guard that was recognized by the Medicare-Eligible Retiree Health Care Fund in 1st Quarter, FY 2004.

Other Financing Sources, Other (Line 5.D.) decreased by $146.0 million due to the reclassification of inventory gains and losses by the Army. Army reports the gains and losses as earned revenue on the Statement of Net Cost rather than Other Financing Sources.

Unexpended Appropriations

The $40.2 billion decrease in Appropriations Received is primarily due to:

- The Department received a supplemental appropriation during 1st Quarter, FY 2004 to conduct Operations Enduring Freedom and Iraqi Freedom, but did not receive a supplemental again in FY 2005. This caused a decrease of approximately $66.2 billion.
- The Department received approximately $24.3 billion more in the FY 2005 Appropriations Act than in the FY 2004 Appropriations Act.

Budgetary Financing Sources, Other Adjustments decreased $3.8 billion. The decrease is due primarily to the $3.5 billion rescission from the Iraqi Freedom Fund in the 1st Quarter, FY 2004. There are no rescissions in FY 2005.

Other Disclosures

There is a difference of $58.9 billion between Appropriations Received that are reported on the Statement of Changes in Net Position ($447.4 billion) and Appropriations Received in the Statement of Budgetary Resources ($506.3 billion). Trust Funds are reported in the Statement of Budgetary Resources but not in the Statement of Changes in Net Position.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of March 31	2005	2004
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 285,279,588,725.53	$ 269,168,731,536.97
2. Available Borrowing and Contract Authority at the End of the Period	55,251,260,765.87	46,931,667,163.14

Fluctuations

The Net Amount of Budgetary Resources Obligated for Undelivered Orders increased $16.1 billion (6 percent). The Army General Fund and Army Working Capital Fund accounted for the majority of this increase.

Available Borrowing and Contract Authority at the End of the Period increased $8.3 billion (17 percent). This fluctuation was primarily attributable to increased reimbursable activity in support of the following contingency missions: Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle in Iraq and Afghanistan. Additionally, the authority available to incur obligations increased for Foreign Military Sales administrative expenses.

The Nonbudgetary section of the SBR, which reports activity for the Military Housing Privatization Initiative, reflects significant variances regarding borrowing authority due to improved accounting policy changes and decreased loan activity. Permanently Not Available and Apportioned Unobligated balances changed significantly due to re-estimates of subsidies and anticipated amounts for the rest of the year had significant differences due to improved accounting policy changes. Overall budgetary resources decreased $90.2 million (68 percent).

Defense Wide

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen's Store (10 USC 2665)
- Burdensharing Contributions Account (10 USC 2350j)
- Forest Program (10 USC 2665)
- Department of Defense Base Closure Account (BRAC 10 USC 2687 note)
- Medicare Eligible Retiree Health Care Fund (10 USC 1111)
- Military Retirement Fund (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Reserve Mobilization Income Insurance Fund (RII) (10 USC 12528)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USC 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670f)
- Ainsworth Bequest (IAW 31 USC 1321)

Reconciliation Differences

There is a difference of $9.2 billion between undelivered orders (UDOs) reported on line 1 in the table above ($285.3 billion) and the amount of UDOs reported for Net Amount of Budgetary Resources Obligated for Undelivered Orders on the SBR ($276.1 billion). This difference is primarily attributable to the process of reporting UDOs with advances. Line 1 reports United States Government Standard General Ledger 4802 (Undelivered Orders - Obligations, Prepaid/Advanced) but the SBR does not. Both lines include upward and downward adjustments of prior-year UDOs.

There is a difference of $10.3 billion between the contract and borrowing authority reported on line 2 in the table above ($55.3 billion) and the amount reported for Available Borrowing and Contract Authority on the SBR ($45.0 billion). Line 2 reports current-year activity as well as carry-forward amounts for both categories of authority. The SBR only reports current-year activity for these categories.

The Department of Treasury issues annual warrants to pay amortized payments for the unfunded actuarial liabilities of the Military Retirement Fund (MRF). This amount is credited and expended from the Other Defense Organizations - General Funds to the MRF in accordance with the Office of Management and Budget (OMB) guidance. As a result, unfunded actuarial liabilities are duplicated within the DoD financial statements. The OMB is aware and approves of this duplicate reporting.

The Medicare-Eligible Retiree Health Care Fund, MRF, Education Benefits Fund, and the Voluntary Separation Incentive Program report Appropriations Received for contributions paid by the Army, Navy, and Air Force. The Military Departments also include these amounts in Appropriations Received. As a result, these amounts are duplicated within the DoD financial statements.

Defense Wide

Intraentity Transactions

The SBR includes intraentity transactions because the statements are presented as combined and combining.

Direct Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)	Totals
Army General Fund	86,348.5	3,341.6		89,690.1
Navy General Fund - see disclosure	87,114.2			87,114.2
Air Force General Fund	33,778.2	30,876.1	0.6	64,654.9
US Army Corps of Engineers	2,825.8		13.4	2,839.2
Military Retirement Fund	19,105.0			19,105.0
Medicare-Eligible Retiree Health Care Fund	4,023.1			4,023.1
Other Defense Organizations – General Fund	79,401.4	350.3		79,751.7
Other Defense Organizations – Working Capital Fund	634.3			634.3
Totals	313,230.5	34,568.0	14.0	347,812.5

Reimbursable Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)	Totals
Army General Fund	9,154.2			9,154.2
Navy General Fund - see disclosure	5,301.1			5,301.1
Air Force General Fund	5,958.3	2,230.7		8,189.0
Army Working Capital Fund		6,912.4	2747.0	9,659.4
Navy Working Capital Fund		11,890.2		11,890.2
Air Force Working Capital Fund	8,171.9			8,171.9
US Army Corps of Engineers	3,543.1		0.5	3,543.6
Other Defense Organizations – General Fund	4,182.3			4,182.3
Other Defense Organizations – Working Capital Fund	27,304.2			27,304.2
Totals	63,615.1	21,033.3	2,747.5	87,395.9

Due to system limitations, the Navy General Fund could not categorize obligations. Therefore, all of Navy's direct and reimbursable obligations are reported in the above table as Category "A."

NOTE:
1. Category "A" relates to appropriations for a specific period of time (e.g. Military Personnel appropriation).
2. Category "B" relates to appropriations for a specific project (e.g. Military Construction appropriation).

Note 21. Disclosures Related to the Statement of Financing

Due to the Department's financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data is a previously identified deficiency. To bring the Statement of Financing into balance with the Statement of Net Cost, the following adjustments (absolute value) were made:

Resources That Finance the Acquisition of Assets	$ 3,775.5 million
Other Components Not Requiring or Generating Resources	$ 594.0 million
Revaluation of Assets or Liabilities	$ 245.6 million
Statement of Net Cost*	$ 7.5 million

*The U.S. Army Corps of Engineers adjusted the Statement of Net Cost instead of the Statement of Financing.

Offsetting receipts increased $6.1 billion due primarily to increases in the contributions to the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund based on computations furnished by the DoD Office of Actuaries.

Transfers In/Out Without Reimbursement decreased by $2.8 billion due primarily to the reduction of transfers in from other federal agencies. In FY 2004, the U.S. Coast Guard transferred $2.8 billion to the Medicare-Eligible Retiree Health Care Fund (MERHCF), which completed the U.S. Coast Guard liability transfer. There were no Coast Guard transfers in FY 2005. This transaction also impacts lines Resources Than Fund Expenses Recognized in Prior Period and Other Resources That Do Not Offset Net Cost of Operations – Other.

Other Resources – Other decreased by $146.0 million primarily due to an Army Working Capital Fund correction to report inventory gains and losses as part of Revaluation of Assets or Liabilities.

Change In Budgetary Resources – A comparative analysis of undelivered orders and unfilled orders is discussed in Note 20, Disclosures to the Statement of Budgetary Resources.

Resources That Fund Expenses Recognized in Prior Period relates to the reduction in the estimates for unfunded liabilities. The $1.4 billion decrease in unfunded liabilities is due primarily to the reduction in environmental liabilities by the Air Force and the Army. For further disclosure on environmental liabilities see Note 14.

Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations increased by $931.8 million due primarily to a change in reporting procedures. Previously, offsetting receipts for special funds were recorded as non-exchange revenue as required by Treasury.

Resources That Finance the Acquisition of Assets decreased by $11.8 billion due primarily to actions to correctly report expenses within the statement. In FY 2004, actions were taken to correctly report cost capitalization offset, gains and losses, inventory values and the Statement of Financing adjustment amounts.

The $10 million increase in Trust or Special Fund Receipts Related to Exchange is due to the receipt of $10 million by the United States Army Corps of Engineers from Treasury for the South Dakota Terrestrial Wildlife Trust Fund which occurred during first quarter, FY2005.

Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations decreased by $2.8 billion. The decrease was caused by the recognition in FY 2004 of a transfer-in of a $2.8 billion liability from the U.S. Coast Guard to the Medicare-Eligible Retiree Health Care Fund. Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations are primarily an offset to Transfers-In/Out Without Reimbursement.

Components Requiring Resources in Future Periods – Other consists of unfunded expenses relating to contingent liabilities, actuarial and other unfunded employment-related liabilities. The cumulative total of unfunded expenses from all fiscal years is reported as "Liabilities Not Covered by Budgetary Resources" in Note 11.

The $14.6 billion decrease in depreciation and amortization was due primarily to revision of military equipment values in FY 2004 by the Bureau of Economic Analysis (BEA), Department of Commerce. The revised valuations resulted in significant decreases in the accounts of Army, Air Force, and Navy.

Revaluation of Assets or Liabilities decreased $2.3 billion, primarily due to the change in reporting gains and losses on inventory valuation by Air Force and Navy, corrections of real property values by the Navy, corrections of inventory values by the Army, and losses on disposals of fixed assets by the United States Army Corps of Engineers.

Components Not Requiring Resources in Future Periods – Other consists of expenses not requiring budgetary resources reported by the Department of the Army for the Iraqi Relief and Reconstruction Fund, the adjustment by the Other Defense Organization General Fund to bring the Statement of Financing into balance with the Statement of Net Cost, depreciation expense related to assets transferred from operating materials & supplies inventory to property, plant and equipment and other corrections made by Air Force General Funds.

Note 22. Disclosures Related to the Statement of Custodial Activity

The Statement of Custodial Activity displays current year collections and disbursements for three custodial accounts: Foreign Military Sales, Development Fund for Iraq, and Seized Assets. Funds held in a Custodial Activity are only used for the stated purposes and are not available for the Department's use.

Foreign Military Sales (FMS)

Current year deposits from foreign governments into the FMS Trust Fund are $4.4 billion and disbursements on behalf of foreign governments and international organizations equal $5.2 billion.

Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. These advance collections constitute a fiduciary relationship with the countries.

FMS neither recognizes nor reports revenue. The only exception is cost clearing accounts, which are reflected in all other components of the Audited Financial Statements except the Statement of Custodial Activity. Since various DoD Components actually perform the services and sell the articles, recognition of revenue and expense occurs in the financial statements of the applicable DoD Components.

Development Fund for Iraq (DFI)

The DFI is for urgent humanitarian assistance, reconstruction, and other projects carried out for the benefit of the Iraqi people. Current year deposits from the Interim Iraqi Government transferred to the Multi-National Force-Iraq are $112.1 million and there have been $ 4.1 million in disbursements.

	(Amount in millions)	
	During FY 2005	Cumulative from Inception
Source of Collections		
Deposits by Foreign Governments	$ 112.1	$ 112.1
Disposition of Collections		
Water Resources and Sanitation	$ 0.1	$ 0.1
Health Care	2.1	2.1
Education, Refugees, Human Rights, and Governance	1.9	1.9
Total Disbursed on Behalf of Foreign Governments	$ 4.1	$ 4.1
Retained for Future Support of Foreign Governments (see note)	108.0	108.0
Total Disposition of Collections	$ 112.1	$ 112.1
Net Custodial Collection Activity	$ 0.0	$ 0.0

Note – Reported on Statement of Custodial Activity under Disposition of Collections, Increase (Decrease) in Amounts to be Transferred.

Seized Assets

During Operation Iraqi Freedom, the U.S. Government seized assets from the Iraqi Government that are used in support of the Iraqi people. As of March 31, 2005, $83.1 million of seized monetary assets remains to be disbursed in support of the Iraqi people as shown in the table below.

	(Amount in millions) During FY 2005	Cumulative from Inception
Source of Collections		
Seized Iraqi Cash	$ 0.0	$ 927.2
Disposition of Collections		
Iraqi Salaries	$ 0.0	$ 30.8
Repair/Reconstruction/Humanitarian Assistance (see note)	29.6	473.3
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	.7	264.7
Fuel/Supplies	0.0	75.3
Total Disbursed on behalf of Iraqi People	$ 30.3	$ 844.1
Retained for Future Support of the Iraqi People	(30.3)	83.1
Total Disposition of Collections	$ 0.0	$ 927.2
Net Custodial Collection Activity	$ 0.0	$ 0.0

Note – Repair/Reconstruction/Humanitarian Assistance reflects $20.7 million previously reported as Iraqi Salaries in 1st Quarter FY 2005.

Note 23. Other Disclosures

As of March 31	2005			
1. ENTITY AS LESSEE- Operating Leases				
Future Payments Due	Land and Buildings	Equipment	Other	Total
Fiscal Year				
2006	$ 187,380,971.84	$ 0.00	$ 145,790,125.00	$ 333,171,096.84
2007	195,593,733.94	0.00	148,705,928.00	344,299,661.94
2008	192,055,087.27	0.00	151,680,046.00	343,735,133.27
2009	185,401,551.53	0.00	154,713,647.00	340,115,198.53
2010	186,402,657.12	0.00	157,807,920.00	344,210,577.12
After 5 Years	164,920,331.48	0.00	160,964,079.00	325,884,410.48
Total Future Lease Payments Due	$ 1,111,754,333.18	$ 0.00	$ 919,661,745.00	$ 2,031,416,078.18

Since second quarter 2004, operating leases have increased $1.3 billion largely due to leases entered into by the Department of Defense in support of contingency operations. Leases of office space comprise most of the remaining balance of the Department’s leases.